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What's Your Priority? Revitalizing Pennsylvania's Approach to Equitable Subrogation of Mortgages After First Commonwealth Bank v. Heller

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WHAT'S YOUR PRIORITY?: REVITALIZING PENNSYLVANIA'S APPROACH TO EQUITABLE SUBROGATION OF MORTGAGES AFTER *FIRST COMMONWEALTH BANK v. HELLER*

GLENN R. MCGILLIVRAY*

"[E]quitable subrogation simply seeks to maintain the proper order of priorities . . . keeping the first mortgage first and the second mortgage second."[1]

I. FIRST THINGS FIRST: INTRODUCTION TO REFINANCING AND PRIORITY LIEN POSITION FOR MORTGAGE LOANS

As the housing market began to crash in 2008, Jan, a single mother of three, found her most prized possession—her home—threatened by foreclosure.[2] After losing her job because of the economic downturn, she was forced to deplete her savings to keep up with her monthly bills.[3] She soon fell behind on her mortgage payments, leaving her with a difficult decision: save her home from foreclosure or continue putting food on the table for her children.[4] A saving grace presented itself when a third party

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1. Bank of Am., N.A. v. Prestance Corp., 160 P.3d 17, 20 (Wash. 2007) (en banc) (adopting Restatement approach with regard to equitable subrogation and holding that lender can be equitably subrogated to first-priority lien despite having actual or constructive notice of junior lienholders).

2. *See generally* Craig E. Pollack & Julia F. Lynch, Op-Ed., *Foreclosures Are Killing Us*, N.Y. TIMES (Oct. 2, 2011), http://www.nytimes.com/2011/10/03/opinion/foreclosures-are-killing-us.html (illustrating vast impact of foreclosure crisis that caused record number of foreclosures). Foreclosure may properly be characterized as a "bona fide public health crisis," as it often results from the illness of homeowners. *Id.* ("When breadwinners become ill, they miss work, lose their jobs, face daunting medical bills—and have trouble making mortgage payments as a result."). Furthermore, foreclosure itself has adverse health effects on homeowners, including increases in anxiety and depression. *See id.*

3. *See generally* Renae Merle & Tomoeh Murakami Tse, *Mortgage Foreclosures Reach All-Time High*, WASH. POST (Mar. 7, 2008), http://www.washingtonpost.com/wp-dyn/content/article/2008/03/06/AR2008030601447.html (noting that more homeowners had fallen into foreclosure than ever before).

4. *See generally* RealtyTrac Staff, *Foreclosure Activity Increases 81 Percent In 2008*, REALTYTRAC (Jan. 15, 2009), http://www.realtytrac.com/content/press-releases/foreclosure-activity-increases-81-percent-in-2008-4551 (reporting approximately 3.2 million foreclosure filings in 2008 from U.S. Foreclosure Market Report).

lender contacted her about refinancing her loan.[5] The lender would provide lower monthly payments on her mortgage by lowering the interest rate and extending the date of fulfillment.[6] With this help, Jan was able to make the new monthly payments once she returned to work, and she avoided foreclosure altogether.[7]

During the mortgage crisis, many Americans faced a similar predicament.[8] After the housing bubble burst and the economy sank into recession, monthly loan payments soared out of reach for many homeowners.[9]

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5. *See generally* Survivors Club Staff, *Refinance While House Is in Foreclosure*, SURVIVORS CLUB, http://www.thesurvivorsclub.org/money/surviving-foreclosure/refinance-while-house-is-in-foreclosure (last visited Feb. 20, 2013) (explaining advantages provided by refinancing when home is in foreclosure).

6. *See generally* Joseph E. Stiglitz & Mark Zandi, Op-Ed., *The One Housing Solution Left: Mass Mortgage Refinancing*, N.Y. TIMES (Aug. 12, 2012), http://www.nytimes.com/2012/08/13/opinion/the-one-housing-solution-left-mass-mortgage-refinancing.html?scp=1&sq=&st=nyt&_r=0 ("More than four million Americans ha[d] lost their homes since housing bubble began bursting . . . . [And] [a]n additional 3.5 million homeowners are in the foreclosure process or are so delinquent on payments that they will be soon."). With interest rates at record lows, mass mortgage refinancing would allow homeowners to drastically reduce their monthly payments and significantly lessen the chance of default. *See id.* (highlighting importance of refinancing). Moreover, mass refinancing is economically beneficial because over half of American homeowners are strong candidates for it, and, accordingly, stand to increase disposable income and spending. *See id.*

7. *See* Gil Mackey, *The Importance of Refinancing: Getting it Right*, MORTGAGE CREDIT PROBLEMS, http://www.mortgagecreditproblems.com/articles/refinancing/the-importance-of-refinancing-getting-it-right.htm (last visited Feb. 20, 2013) ("Refinancing your mortgage is a great way to lower your monthly payments, get a better interest rate, or take advantage of home equity for a cash loan . . . ."). Common loan types for refinancing a mortgage are: (1) fixed-rate, (2) adjustable-rate, (3) interest-only, and (4) hybrid, which all may provide different advantages (or pitfalls) to the borrower. *See id.* (suggesting that prospective borrowers shop around to find most beneficial mortgage for refinancing).

8. *See generally* Sunayana Mehra, MOODY'S ANALYTICS: METHODOLOGY FOR FORECASTING FORECLOSURES 7 (2011), *available at* https://www.economy.com/home/products/samples/RealtyTrac_Methodology_062011.pdf (noting that late-stage delinquency rates and local economic conditions such as house price depreciation and job loss are main drivers of foreclosures); *see also Mortgages and the Markets*, N.Y. TIMES (Aug. 25, 2011), http://topics.nytimes.com/top/reference/timestopics/subjects/m/mortgages/index.html (explaining mortgage crisis of 2008). The mortgage crisis was caused in part by the purchase of homes during the real estate boom by many unqualified buyers who could not afford the payments as "the economy turned down and layoffs soared." *Id.* ("By late 2008, as the wheels were coming off Wall Street, some economists were estimating that 8 million to 10 million borrowers might lose their homes because they could not afford to repay or refinance their loans."). *See* Editorial, *Still No Justice for Mortgage Abuses*, N.Y. TIMES (Sept. 1, 2012), http://www.nytimes.com/2012/09/02/opinion/sunday/still-no-justice-for-mortgage-abuses.html (discussing settlement between large banks and state and federal officials for widespread foreclosure fraud). Nearly 3 million borrowers are in or near foreclosure. *See id.* (citing disproportionate number of short sales relative to principal reductions from loan modification).

9. *See* Grant S. Nelson, *Confronting the Mortgage Meltdown: A Brief for the Federalization of State Mortgage Foreclosure Law*, 37 PEPP. L. REV. 583, 584 (2010) (noting high unemployment rates, rising foreclosure levels, and increased welfare rolls); *see*

A driving force behind the mortgage crisis was the issuance of subprime mortgages.[10] These mortgages allowed people with low incomes and less-than-stellar credit scores to purchase homes that they otherwise could not afford.[11] When housing prices declined, many of these borrowers were left "under water," with their homes valued at less than their mortgage loans.[12] Coupled with the overall economic downturn, many of these homeowners were forced into foreclosure.[13]

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also Mortgages and the Markets, *supra* note 8 ("Mortgages form the financial underpinnings of the nation's housing market and have allowed more than two-thirds of households to own their own homes."). Wide-spread refinancing would provide a strong stimulus for the economy because it would lower borrowers' mortgage payments immediately, allowing them to invest savings elsewhere. *See id.* (encouraging refinancing as solution to problems in housing market).

10. *See* Kevin M. Baum, Note, *Apparently, "No Good Deed Goes Unpunished": The Earmarking Doctrine, Equitable Subrogation, and Inquiry Notice Are Necessary Protections When Refinancing Consumer Mortgages in an Uncertain Credit Market*, 83 ST. JOHN'S L. REV. 1361, 1361 n.1 (2009) (explaining need for—and advantages of—refinancing for Americans with subprime mortgages). Subprime mortgages allowed individuals who could not qualify for traditional loans to take out mortgages to purchase homes. *See id.* (reporting high default rate for subprime borrowers); *see also* Nelson, *supra* note 9, at 585 (explaining how subprime mortgages were integral part of real estate bubble). Subprime mortgages are security interests that do not meet traditional credit standards, but were approved during the housing boom. *See id.*

11. *See* Steven Gjerstad & Vernon L. Smith, Opinion, *From Bubble to Depression?*, WALL ST. J. (Apr. 6, 2009), http://online.wsj.com/article/SB123897612802791281.html (explaining that housing bubble began in 1997, while price decline began in 2006). By 2008, falling home prices left many homeowners under water, with a house less valuable than the loan they took out to pay for it. *See id.* (noting that 10.5 million households had negative equity in December 2008).

12. *See* Merle, *supra* note 3 (reporting that percentage of outstanding mortgages in foreclosure reached all-time high). The default rate was particularly high among homeowners with subprime loans. *See id.* (noting that forty-two percent of homeowners had adjustable subprime loans).

13. *See* Stephanie Armour, *2008 Foreclosure Filings Set Record*, USA TODAY (Feb. 3, 2009), http://usatoday30.usatoday.com/money/economy/housing/2009-01-14-foreclosure-record-filings_N.htm (noting that home foreclosures rose eighty-one percent in United States from 2007 to 2008). Banks repossessed more than 850,000 properties in 2008, compared to 404,000 in 2007. *See id.* ("With foreclosures continuing to rise and the economy in a downward spiral, it's not surprising you see increased foreclosures because of increased unemployment. . . ." (quoting former Federal Deputy Housing Commissioner Ira Peppercorn)); Amy Fontinelle, *Buying A Home: Introduction*, INVESTOPEDIA, http://www.investopedia.com/university/home/ (last visited Feb. 20, 2013) (presenting steps potential homebuyer must take to purchase home and explaining process to acquire loan from standpoint of both borrower and lender); *see also Buying a Home*, U.S. DEP'T OF HOUS. & URBAN DEV., http://portal.hud.gov/hudportal/HUD?src=/topics/buying_a_home (last visited Sept. 10, 2012) (instructing prospective home purchasers on how to find competitive mortgages, interest rates, and home-buying programs). This site provides calculators to determine how large a loan a person can afford. *See id.* (explaining benefits of buying versus renting); *Foreclosure Statistics*, NEIGHBOR WORKS AM., http://www.fdic.gov/about/comein/files/foreclosure_statistics.pdf (last visited Feb. 22, 2013) (providing foreclosure statistics in United States prior to 2008 and detailing problems homeowners face when dealing with foreclosure).

When a homeowner defaults on a mortgage loan the lender has the right to foreclose on the property.[14] During the mortgage crisis, many homeowners elected to refinance their loans to combat high monthly payments and avoid foreclosure.[15] In other words, the homeowners used the proceeds from a new loan to pay off the balance of their original loan.[16] In general, homeowners look to refinance when interest rates on mortgage loans are low or when they need additional capital.[17] Thus, homeowners nearing foreclosure capitalized on the historically-low interest

14. *See* Debra Pogrund Stark, *Facing the Facts: An Empirical Study of the Fairness and Efficiency of Foreclosures and a Proposal for Reform*, 30 U. MICH. J.L. REFORM 639, 639 (1997) (noting that real estate foreclosures are expensive and time consuming, needlessly increasing costs associated with making loans). A real estate mortgage is an interest in real estate, offered by a homeowner in order to secure a specific debt. *See id.* at 643 (explaining that when mortgagor defaults on payment of debt secured by mortgage, acceleration clause makes the entire indebtedness due immediately). Under the current foreclosure process, a mortgage holder has a right to foreclose on the property, while the borrower typically has a period of time to pay off debt before the lender forces the sale of the property. *See id.* (noting two dominant forms of foreclosure in United States: (1) judicial foreclosure sale and (2) non-judicial foreclosure sale).

15. *See* RESTATEMENT (THIRD) OF PROP.: MORTGS. § 7.6 cmt. b (1997) ("A person's interest in real estate may be jeopardized by the threat of foreclosure of a prior mortgage."). The Restatement recognizes that paying off a mortgage may be the only practical way to protect a lender's interest. *See id.* (recognizing importance of refinancing). *See also* Sang Jun Yoo, Note, *A Uniform Test for the Equitable Subrogation of Mortgages*, 32 CARDOZO L. REV. 2129, 2136 (2011) (defining mortgage refinancing as transaction where existing mortgage is discharged and replaced with new mortgage). Homeowners typically refinance when interest rates on new mortgage loans are lower than on their existing loans or when the homeowner needs additional capital. *See id.* (indicating that refinancing mortgagees only agree to issue refinancing mortgage on condition that prior property interests are satisfied). *See also* Armour, *supra* note 13 (noting that homeowners are capitalizing on falling interest rates to lower monthly mortgage payments). Refinancing applications comprised eighty-five percent of all mortgage applications in 2008. *See id.* (marking highest rates of refinancing since 2003).

16. *See* MICHAEL T. MADISON ET AL., 1 LAW OF REAL ESTATE FINANCING § 8:3 (2012) ("'Refinancing' simply means the substitution of a new loan for an existing one . . . that is more expensive."). The purpose is to discharge a more expensive mortgage loan, reduce interest expenses, or extend the loan term. *See id.* (noting that lien priority issues may arise in refinancing where intervening junior lienholder asserts priority over refinance mortgage); *see also* Grant S. Nelson & Dale A. Whitman, *Adopting Restatement Mortgage Subrogation Principles: Saving Billions of Dollars for Refinancing Homeowners*, 2006 BYU L. REV. 305, 312 (2006) (explaining refinancing process as applied to mortgage loans); Lucy Madison, *Obama Unveils Mortgage Refinancing Plan*, CBS NEWS (Feb. 1, 2012), http://www.cbsnews.com/8301-503544_162-57369731-503544/obama-unveils-mortgage-refinancing-plan/ (revealing proposal to make it easier for Americans to refinance their mortgages); Stiglitz & Zandi, *supra* note 6 (finding that refinancing would allow homeowners to reduce monthly payments and increase money for disposable income).

17. *See* Yoo, *supra* note 15, at 2136 (explaining that homeowners typically seek refinancing when interest rates are low or when they need additional capital).

rates, allowing them to shop around for more favorable loan agreements.[18]

In a refinancing transaction, the lender only agrees to pay off the original mortgage loan "on the condition that all prior interests on [the] property are satisfied."[19] If an undisclosed lien remains on the property the lender may find itself in a secondary lien position.[20] Lien priority is crucial to mortgage lenders because, in the event of foreclosure, the lienholder with the highest priority is the first to receive foreclosure proceeds.[21] Therefore, lenders are reluctant to refinance loans in states where they are not ensured that they will be the primary lienholder on the property.[22]

One of the most important concepts for refinancing lenders is equitable subrogation.[23] This common law doctrine allows a lender who pays

18. *See* Rachel Louise Ensign, *It's a Good Time to Refinance*, WALL ST. J. (Mar. 23, 2012), http://online.wsj.com/article/SB10001424052702303812904577295762407392928.html (reporting that interest rates are beginning to increase after country's mortgage crisis, so it may be time to initiate refinancing proceedings). The article makes it clear that "[i]f you're considering refinancing, there's really no point in waiting." *See id.* (encouraging homeowners to refinance). Also, the author explains that one may choose to refinance for a shorter-term loan, thus allowing the borrower to pay off the loan more quickly; others may choose to extend the pay off period, which would take the borrower longer to pay off, but with lower monthly payments. *See id.* (noting that refinance deals vary depending on borrower's financial situation and location); *see also* Vickie Elmer, *Complaints Against Lenders*, N.Y. TIMES (Sept. 6, 2012), http://www.nytimes.com/2012/09/09/realestate/mortgages-complaints-against-lenders.html (noting "fatigue and frustration" of borrowers attempting to modify or refinance their loans (citing CONSUMER FIN. PROT. BUREAU, SEMI-ANNUAL REPORT 17 (2012)).

19. *See* Yoo, *supra* note 15, at 2136 (noting that refinancing lenders agree to issue refinancing loan on condition that all prior interests are satisfied).

20. *See id.* (explaining that mortgage refinancers obtain title searches to identify all prior interests on property that must be satisfied).

21. *See* Nelson & Whitman, *supra* note 16, at 305 n.2 (noting that priority is "critical" to mortgage lenders). If an intervening lien acquires priority over the refinancing lender, there is a much higher risk that the foreclosure proceeds will be insufficient to pay the mortgage obligation in full. *See id.* (recognizing possible windfall that could be granted to intervening lienholder).

22. *See* Bank of Am., N.A. v. Prestance Corp., 160 P.3d 17, 25 (Wash. 2007) (en banc) (finding that lender providing funds to pay off existing mortgage expects to receive same security as loan being paid off). Furthermore, the court recognized that refinancing is "common place" in today's economy. *Id.* (adopting Restatement approach to equitable subrogation in context of refinancing); *see also* Adam M. Starr, *Moving up in a Down Market: Rediscovering Equitable Subrogation*, REAL EST. NEWSALERT (Miller Starr Regalia, Walnut Creek, Cal.), May 2009, *available at* http://www.msrlegal.com/mediafiles/moving-up-in-a-down-market-rediscovering-equitable-subrogation.pdf (noting that lenders are turning to equitable subrogation to preserve and protect their real property security from intervening liens).

23. *See* Henry C. Winiarski Jr., *Equitable Subrogation in the Context of Interests in Real Property: The Basics and the Areas Needing Authoritative Clarification*, 85 CONN. B.J. 231, 232 (2011) (explaining that equitable subrogation prevents injustice in form of unjust enrichment). Furthermore, courts primarily apply the doctrine to adjust the priority of real property interests by substituting one party for another. *See id.* (defining equitable subrogation as "remedy of restoration" that restores order of

the obligation of another to take the lien position of the prior lender.[24] States vary in their approach to equitable subrogation, ranging from restrictive to liberal.[25] Pennsylvania's approach is relatively conservative as compared to other states, disallowing subrogation in most refinancing contexts.[26] For example, in *First Commonwealth Bank v. Heller*,[27] defendant Catharine Heller took out a loan in order to refinance the mortgages on her property.[28] Ameriquest, the refinancing lender, agreed to grant the loan under the assumption that it would take a priority lien position on her property.[29] In reality, an intervening lien remained undisclosed, so

priorities by allowing party to assume status or priority previously enjoyed by another party). The author explains that the doctrine is used to maintain an order of priorities that was unintentionally altered by mistake. *See id.* (noting that mistakes are often caused by attorneys or title searchers).

24. *See* RESTATEMENT (THIRD) PROP.: MORTGS. § 7.6 cmt. b (1997) ("A person's interest in real estate may be jeopardized by the threat of foreclosure of a prior mortgage. Performing that mortgage obligation may be the only or most feasible means of protecting the interest."); *see also* Yoo, *supra* note 15, at 2131 (recognizing that equitable subrogation assigns priority rights that original creditor would have held, had debt not been satisfied, to party who satisfied debt). The author explains that in the context of mortgage refinancing, equitable subrogation works to resolve problems caused by undiscovered intervening liens. *See id.* (illustrating how refinancing mortgagee is provided priority rights accruing from mortgage or lien that was satisfied).

25. *See Prestance*, 160 P.3d at 21 ("Courts generally consider knowledge in one of three ways when applying equitable subrogation to a refinancing lender."). The court lists the three approaches: "[1] the Restatement approach that says actual or constructive knowledge of intervening interests is irrelevant; [2] a minority approach that says a plaintiff with either actual or constructive knowledge cannot seek equitable subrogation; . . ." and (3) a majority approach that allows equitable subrogation with constructive knowledge, but not with actual knowledge. *See id.* (applying Restatement approach after discussing merits and drawbacks to each alternative); *see also* John C. Murray, *Equitable Subrogation: Can a Refinancing Mortgagee Establish Priority Over Intervening Liens?*, 45 REAL PROP. TR. & EST. L.J. 249, 251 (2010) [hereinafter Murray, *Refinancing*] (indicating that courts have adopted three different jurisdictional approaches to equitable subrogation). The author notes that while many cases and commentators favor the Restatement approach, it is still not the majority position. *See id.* (demonstrating benefits of Restatement approach).

26. *See generally* Harris Ominsky, *Mortgage Priorities: Pennsylvania Rule May Impair Refinancing*, REAL EST. L. REP., Oct. 2008 (discussing Pennsylvania's approach to equitable subrogation and how it differs from Restatement approach). The author argues that Pennsylvania's current approach could impair borrowers' ability to refinance their loans. *See id.* (noting that Superior Court of Pennsylvania in *1313466 Ontario, Inc. v. Carr*, 954 A.2d 1 (Pa. Super. Ct. 2008) suggested legislative review); *see also* Laurie Fiore, *Using Equitable Subrogation in Title Disputes in Pennsylvania*, COMPLEX TITLE ISSUES, at 139 (2005) (describing elements of Pennsylvania approach and cases that have failed to meet each element).

27. 863 A.2d 1153 (Pa. Super. Ct. 2004).

28. *See id.* at 1154 (stating that Heller received $119,000 loan to pay off prior loans on her property). At this point there were still three loans encumbering the property, but Heller only paid off two, leaving one remaining. *See id.* (noting that Ameriquest's loan was subordinate).

29. *See id.* (noting that public record revealed three mortgages when loan was executed). Ameriquest's loan was used to pay off two loans from 1990 and 1995

Ameriquest was forced to take a secondary lien position.[30] By denying Ameriquest subrogation, the court punished a lender for providing a struggling homeowner the opportunity to refinance.[31] The court held that Ameriquest was not entitled to equitable subrogation because it was a volunteer and did not have an interest in paying off the prior loans.[32]

This Note argues that the current state of Pennsylvania's equitable subrogation law is outdated, and urges the state, through judicial opinion or legislation, to take a more liberal approach to such a valuable legal doctrine.[33] Part II explains the history of the doctrine and details the vary-

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respectively, but First Commonwealth's 2000 mortgage remained. *See id.* (finding that First Commonwealth held primary lien position).

30. *See id.* (explaining that First Commonwealth's 2000 mortgage took priority over Ameriquest's new mortgage). Thus, the 2000 lien took priority position on the property when Ameriquest's loan proceeds were used to pay off the 1990 and 1995 loans. *See id.* (recognizing that Ameriquest should have been aware of First Commonwealth's mortgage because title search would have revealed lien); *see also* RESTATEMENT (THIRD) OF PROP.: MORTGS. § 7.6 cmt. b (1997) (stating that person's interest in real property is jeopardized by threat of foreclosure of priority mortgage). Furthermore, paying off the prior mortgage may be the only practical way to protect a lender's interest. *See id.* (illustrating importance of equitable subrogation in protecting lienholder's interest in property); 73 AM. JUR. 2D *Subrogation* § 58 (2012) (defining "intervening lienholder" as one that intervenes in sequence when there has been prior, intervening lien, followed by release of prior lien, and creation of new lien in favor of party who funded release of prior lien). Moreover, in order to avoid unjust enrichment in favor of the intervening lienholder, the mortgagee is entitled to subrogation to the rights of the senior encumbrance. *See id.* (demonstrating role subrogation plays in protecting refinancing lender's interests).

31. *See Heller*, 863 A.2d at 1160 (holding that Ameriquest was not entitled to remedy of equitable subrogation). Furthermore, court held that First Commonwealth had every right to foreclose on the property as the priority lienholder. *See id.* (noting that Ameriquest's negligence in failing to discover intervening lien caused it to be junior to First Commonwealth's mortgage). The court explained that Ameriquest filed a petition to intervene seeking to assert its right to equitable subrogation. *See id.* at 1154 (revealing that default judgment was entered against Heller and writ of execution was granted, allowing Sheriff to foreclose on her house). Ameriquest filed a petition to stay the sheriff's sale, which the court granted, but then vacated after denying its petition to intervene. *See id.* at 1154–55 (holding that Ameriquest had not demonstrated prerequisites to establish remedy of equitable subrogation).

32. *See id.* at 1160 (holding that Ameriquest was not entitled to equitable subrogation and thus secured subordinate interest to First Commonwealth's lien). The court found that First Commonwealth had the undisputed right to foreclose in priority position and that it was not necessary to protect Ameriquest's interest. *See id.* (finding that intervening in case would not be necessary to provide Ameriquest relief). In addition, it found that "courts of equity will not relieve a party from the consequences of error due to his own ignorance or carelessness when there were available means which would have enabled him to avoid the mistake if reasonable care had been exercised." *Id.* at 1159 (quoting Home Owners' Loan Corp. v. Crouse, 30 A.2d 330, 332 (1943)) (internal quotation marks omitted).

33. *See* Nelson & Whitman, *supra* note 16, at 305–06 (explaining that making subrogation available liberally can eliminate risk that intervening liens will take priority over refinancing mortgages). In recent years, many courts have adopted the Restatement approach or followed its logic. *See id.* at 314 (finding that Restate-

ing approaches taken by different jurisdictions in the United States.[34] Part III discusses the doctrine's development within Pennsylvania and how the court applied it leading up to *Heller*.[35] Part IV addresses how the Superior Court of Pennsylvania applied the doctrine in *Heller* and describes the effect that this decision has on lenders, borrowers, and refinancing in general.[36] Finally, Part V looks to other states for more liberal approaches to equitable subrogation and provides Pennsylvania with a solution to its problematic approach.[37] In order for Pennsylvania to keep up with the current trend in courts and foster sound economic policy, it must adopt the Restatement approach to equitable subrogation.[38]

II. BUILDING UP: THE DEVELOPMENT OF EQUITABLE SUBROGATION IN PENNSYLVANIA

While other states continue to expand the doctrine of equitable subrogation, Pennsylvania maintains a restrictive approach.[39] In Pennsylvania, a lender cannot employ equitable subrogation if the lender is considered a "mere volunteer."[40] This approach prevents the application of the doctrine in almost all refinancing contexts and greatly restricts its fundamental purpose.[41]

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ment takes expansive view of applying equitable subrogation). Furthermore, the article urges states to adopt the Restatement approach because it is "friendly" to first mortgage refinancing. *See id.* at 327–28. Finally, the authors argue that lenders and title insurers support the adoption of the Restatement approach because it "dramatically reduces the financial risk . . . posed by intervening lien[-holders]." *See id.* at 353 (noting that Restatement approach would greatly reduce need for title insurance in refinancing).

34. For a further discussion of the history of equitable subrogation and the different jurisdictional approaches, see *infra* notes 39–98 and accompanying text.

35. For a further discussion of the facts, holding, and rationale of *Heller*, see *infra* notes 99–165 and accompanying text.

36. For a further discussion of how Pennsylvania courts have applied the doctrine established in *Heller*, see *infra* notes 166–68 and accompanying text. For a further discussion of other states' approaches to equitable subrogation, see *infra* notes 180–202 and accompanying text. For a further discussion of why Pennsylvania should change its approach to equitable subrogation, see *infra* notes 203–25.

37. For a further discussion of the recommended alternative to Pennsylvania's approach see *infra* notes 226–33 and accompanying text.

38. *See infra* notes 226–33 (arguing that Pennsylvania should adopt Restatement approach to equitable subrogation).

39. *See Heller*, 863 A.2d at 1153, 1158 (requiring four-part test for equitable subrogation to apply).

40. *Id.* at 1158–59 (noting that claimant cannot act as volunteer).

41. *See* Ominsky, *supra* note 26 (noting that lender who extends loan to pay off earlier loan is "volunteer" in Pennsylvania).

A. *History of Equitable Subrogation: Background and General Approaches*

Originally, equitable subrogation was only applied in the context of sureties, however, its application expanded over time.[42] The doctrine was then adopted in the context of mortgage refinancing, where it protected lenders from losing priority position.[43] Most courts recognize that the doctrine is based in equity and apply it in a manner that prevents unjust enrichment and an unearned windfall.[44] In the context of mortgage loans, subrogation applies when loan proceeds from a new loan are used to satisfy a prior lien.[45] When this occurs, the new lender—i.e., refinancing lender—stands in the shoes of the prior lienholder.[46] In general, the doctrine applies when a person has assumed or satisfied the obligation of another and thus obtains the rights, priorities, liens, and remedies of the former obligee.[47]

42. *See* Gregg H. Mosson, Comment, *Equitable Subrogation in Maryland Mortgages and the Restatement of Property: A Historical Analysis for Contemporary Solutions*, 41 U. BALT. L. REV. 709, 715 (2012) (explaining that concept of subrogation evolved from British common law when surety guaranteed debt, was forced to pay upon default, and after paying, appealed to equity court to pursue repayment from defaulting debtor). American equity courts first granted this right based on principles of justice, and legal courts increasingly adopted it to compel discharge of debt by party that should pay it. *See id.*.

43. *See* RESTATEMENT (THIRD) OF PROP.: MORTGS. § 7.6 cmt. a (1997) ("[Subrogation] may arise when one pays or performs in full an obligation owed by another and secured by a mortgage.").

44. *See* Note, *Subrogation of Purchaser to Rights of Senior Mortgagee Against Junior Encumbrances*, 48 YALE L.J. 683, 683 (1939) [hereinafter *Subrogation*] (describing subrogation as substitution of one person in place of another with reference to lawful claim or right). The author further states that the doctrine is purely equitable and is applied when a prospective subrogee assumes or satisfies an obligation for which another is primarily liable. *See id.* at 683–84 (noting equitable nature of subrogation and importance of liberal application).

45. *See* John C. Murray, *Equitable Subrogation: Is the Trend Toward the Restatement Approach?*, 21 PROB. & PROP. 19, 19 (Dec. 2007) [hereinafter Murray, *Trend*] (stating that doctrine of equitable subrogation generally provides that new lender stands in shoes of prior lienholder when proceeds from new loan are used to satisfy prior lien). The article recognizes that equitable subrogation is designed to prevent a windfall amounting to an unjust enrichment for the intervening lienholder. *See id.* (explaining that purpose of equitable subrogation is to prevent unjust enrichment).

46. *See* 73 AM. JUR. 2D *Subrogation* § 58 (2012) ("Under the doctrine of equitable subrogation, where fairness and justice require, one who advances money to discharge a prior lien on real or personal property and takes a new mortgage as security is entitled to be subrogated to the rights under the prior lien against the holder of an intervening lien of which he was ignorant."). Equitable subrogation serves as an exception to modern recording statutes when determining priority of multiple mortgage interests. *See id.* (illustrating that equitable subrogation enables lender to step into shoes of prior mortgagee in order to receive that mortgagee's priority over subsequent liens).

47. *See* Robert M. Smith, Note, *What Happened to the Equity in Equitable Subrogation?:* Metmore Financial, Inc. v. Landoll Corp., 64 MO. L. REV. 503, 503 (1999) ("The doctrine of equitable subrogation provides courts with a vehicle to allow a lending institution that has paid off an existing loan to take the original lending institution's place in priority status.").

Courts recognize two types of subrogation: (1) conventional and (2) equitable (or legal).[48] Conventional subrogation requires an express or implied agreement that one lienholder will be subrogated to the position of another.[49] On the other hand, equitable subrogation is not based on agreement, but rather the equities of the particular case.[50] Therefore, equitable subrogation has developed a complicated history in common-law, as it is applied differently from state to state.[51]

Courts have adopted three different approaches to equitable subrogation, reflecting different apportionments of equity: (1) the majority position holds that a party with actual knowledge of an intervening lien cannot seek equitable subrogation; (2) the minority position holds that a party with actual or constructive knowledge of an intervening lien cannot seek equitable subrogation; and (3) the *Third Restatement of Property* approach states that actual or constructive knowledge of an intervening lien is irrelevant and does not bar application of equitable subrogation.[52] Many schol-

48. *See Subrogation*, *supra* note 44, at 684 (noting distinction between conventional and legal subrogation). The author goes on to state that the boundaries of subrogation are difficult to describe, and that the tendency is to extend the usefulness of the doctrine. *See id.* at 685 (describing different approaches to doctrine); *see also* Murray, *Refinancing*, *supra* note 25, at 267 ("There are two broad categories of subrogation rights: contractual or conventional rights, and common-law or equitable rights." (quoting Aames Capital Corp v. Interstate Bank of Oak Forest, 734 N.E.2d 493, 498 (Ill. App. Ct. 2000))). The author explains that equitable subrogation is utilized to prevent unjust enrichment, while conventional subrogation arises from agreement. *See id.* (explaining difference between conventional and legal subrogation).

49. *See* Aames Capital Corp. v. Interstate Bank of Oak Forest, 734 N.E.2d 493, 498 (Ill. App. Ct. 2000) (noting that conventional subrogation arises from express or implied understanding, where one party pays debt of another and by agreement is entitled to rights of original creditor).

50. *See id.* (explaining that equitable subrogation is common law doctrine used to prevent unjust enrichment). There is no general rule for applying equitable subrogation, "since the right depends upon the equities of each particular case." *Id.* (describing different instances where doctrine applies).

51. *See* 73 AM. JUR. 2D *Subrogation* § 58 (2012) (stating that decisions for equitable subrogation are based on equity, as courts' goals are to avoid windfalls and prejudice to interests of junior lienholders.); *see also* Bruce H. White & William L. Medford, *Equitable Subrogation: The Saving Grace for Unperfected Lenders?*, 24 AM. BANKR. INST. J. 38, 38 (2005) ("Because equitable subrogation is a state law doctrine, it may differ from state to state or may not exist at all, and its application will differ.").

52. *Compare* Aurora Loan Servs. L.L.C. v. Senchuk, 36 So.3d 716, 724 (Fla. Dist. Ct. App. 2010) (applying majority approach, finding that constructive notice did not preclude equitable subrogation), *with* Mortg. Elec. Registration Sys., Inc. v. Roberts, 366 S.W.3d 405, 409 (Ky. 2012) (applying minority approach, holding that constructive notice did preclude equitable subrogation), *and* Bank of Am., N.A. v. Prestance Corp., 160 P.3d 17, 29 (Wash. 2007) (en banc) (applying Restatement approach and finding that equitable subrogation should be applied to prevent unjust enrichment). *See also* RESTATEMENT (THIRD) OF PROP.: MORTGS. § 7.6(a) (1997), which states in relevant part:

> One who fully performs an obligation of another, secured by a mortgage, becomes by subrogation the owner of the obligation and the mortgage to the extent necessary to prevent unjust enrichment. Even though the per-

ars recognize that a liberal application of equitable subrogation preserves the equitable nature of the doctrine.[53]

1. *Majority Approach: No Actual Knowledge*

The majority position allows equitable subrogation in many cases, except those where the lender had actual knowledge of a prior lien.[54] This

formance would otherwise discharge the obligation and the mortgage, they are preserved and the mortgage retains its priority in the hands of the subrogee.

Id. (providing liberal approach to equitable subrogation).

53. *See* RESTATEMENT (THIRD) OF PROP.: MORTGS. § 7.6 cmt. a (1997) ("Subrogation is an equitable remedy designed to avoid a person's receiving an unearned windfall at the expense of another."). The doctrine of equitable subrogation rests on the equitable maxim that a person should not be enriched by another person's (or lender's) loss. *See* Murray, *Refinancing*, *supra* note 25, at 250–52 (noting that trend in case law and commentary appears to be toward Restatement approach, as it is most favorable to lenders, prevents unjust enrichment, and ensures intervening lienholders do not receive windfall in form of priority lien position); Murray, *Trend*, *supra* note 45, at 19 (explaining that doctrine is used to prevent unjust enrichment). Equitable subrogation is designed to prevent unjust forfeiture on one hand and a windfall in the form of unjust enrichment on the other. *See id.* (finding that equity should be enforced as justice requires).

54. *See, e.g.*, Foster v. Porter Bridge Loan Co., 27 So. 3d 481, 488 (Ala. 2009) (holding that constructive notice will not preclude application of equitable subrogation); Newberry v. Scruggs, 986 S.W.2d 853, 858 (Ark. 1999) (finding that equitable subrogation applied when judgment lien prevented refinancing mortgagee from taking priority position); Equicredit Corp. of Conn. v. Kasper, 996 A.2d 1243, 1246 (Conn. App. Ct. 2010) (holding that equitable subrogation did not apply because plaintiff had actual and constructive notice of defendant's lien); E. Sav. Bank v. Cach, L.L.C., 55 A.3d 344, 350 (Del. 2012) (denying right to apply equitable subrogation); HSBC Bank USA, N.A. v. Mendoza, 11 A.3d 229, 235 (D.C. 2010) ("[L]ender who pays off a pre-existing mortgage and takes a new mortgage as security for the loan will be subrogated to the rights of the first mortgagee as against any intervening lienholders, even if the lender is on constructive notice."); *Senchuk*, 36 So. 3d at 721–22 (holding that lender was entitled to equitable subrogation and that constructive notice did not preclude application); Chase Manhattan Mortg. Corp. v. Shelton, 722 S.E.2d 743, 748 (Ga. 2012) (finding that equitable subrogation was not available based on lenders inexcusable neglect); Beneficial Haw., Inc. v. Kida, 30 P.3d 895, 920 (Haw. 2001) (holding that equitable subrogation could not be applied because other party did not have right to foreclose); State v. Cont'l Cas. Co., 879 P.2d 1111, 1115 (Idaho 1994) (finding that state was not volunteer and thus was entitled to equitable subrogation); Home Owners' Loan Corp. v. Rupe, 283 N.W. 108, 111 (Iowa 1938) (applying equitable subrogation, stating that intervener was not misled or injured); United Carolina Bank v. Beesley, 663 A.2d 574, 576 (Me. 1995) (holding that mortgagee was entitled to equitable subrogation); G.E. Capital Mortg. Servs. v. Levenson, 657 A.2d 1170, 1179 (Md. 1995) (finding that equitable subrogation could be applied prior to successful foreclosure sale); Grenada Bank v. Young, 104 So. 166, 168 (Miss. 1925) (holding that appellee was not volunteer and thus entitled to subrogation); Shipman v. Terrill, 276 P. 21, 24 (Mont. 1929) (recognizing doctrine of equitable subrogation); Am. Nat'l Bank v. Clark, 670 N.W.2d 484, 489 (Neb. Ct. App. 2003) (per curiam) (finding that negligence on behalf of title insurer did not preclude equitable subrogation claim); Chase v. Ameriquest Mortg. Co., 921 A.2d 369, 377 (N.H. 2007) (holding that all four elements of equitable subrogation claim were satisfied); Am. Gen. Fin. Servs., Inc. v. Barnes, 623 S.E.2d 617, 619 (N.C. Ct. App. 2006)

rule holds that actual knowledge of an existing lien precludes application of equitable subrogation, while constructive knowledge of such a lien does not.[55] Supporters of this doctrine rely on three arguments.[56] First, they contend that granting equitable subrogation liberally would contradict the stability and predictability of the recording rule "first in time, first in right."[57] Second, allowing subrogation with actual knowledge would permit a party to knowingly achieve a higher priority position through equity when it could not have done so otherwise.[58] Third, courts suggest that a

(denying equitable subrogation because refinancing mortgagee was not compelled to refinance loan and failed to properly search public records); ABN AMRO Mortg. Grp. v. Kangah, 126 Ohio St.3d 425, 2010-Ohio-3779, 934 N.E.2d 924, 927 (holding that negligence and prejudice to junior lienholder precluded application of equitable subrogation); Dimeo v. Gesik, 98 P.3d 397, 402 (Or. Ct. App. 2004) (finding that bank had reasonable basis for asserting equitable subrogation claim); Highmark Fed. Credit Union v. Wells Fargo Fin. S.D., 2012 S.D. 38, ¶¶ 7–9, 814 N.W.2d 814, 817 (holding that equitable subrogation did not apply because bank failed to accompany loan with written demand to satisfy mortgage as provided by statute); Bankers Trust Co. v. Collins, 124 S.W.3d 576, 579 (Tenn. Ct. App. 2003) (denying equitable subrogation because debt was not paid through fraud or mistake); Homeside Lending, Inc. v. Miller, 2001 UT App 247, ¶¶ 21–27, 31 P.3d 607, 612 (holding that without mistake or fraud, it would be inappropriate to apply equitable subrogation); Centreville Car Care, Inc. v. N. Am. Mortg. Co., 559 S.E.2d 870, 874 (Va. 2002) (reversing decision awarding equitable subrogation because it would prejudice junior lienholder); Countrywide Home Loans, Inc. v. First Nat'l Bank of Steamboat Springs, N.A., 2006 WY 132, ¶¶ 20–22, 144 P.3d 1224, 1230 (declining to adopt Restatement approach to equitable subrogation).

55. *See Bank of Am., N.A.*, 160 P.3d at 22–23 (noting that majority approach is followed by many jurisdictions, but not all). The court recognized that the majority approach engenders belief that constructive notice should not block equitable subrogation, but that actual knowledge of intervening liens does preclude use of the doctrine. *See id.* at 22 (electing not to follow this approach); Houston v. Bank of Am. Fed. Sav. Bank, 78 P.3d 71, 73 (Nev. 2003) (explaining that majority of states preclude application of equitable subrogation when lienholder had actual knowledge of existing lien); *see also* Melinda Margolies & Brian Margolies, *Equitable Subrogation and Negligent Title Searches: When Title Insurance Becomes Irrelevant*, DRI TODAY, http://clients.criticalimpact.com/newsletter/newslettercontentshow1.cfm?contentid=12053&id=1375 (last visited Oct. 1, 2012) (noting that majority rule precludes application of equitable subrogation when subsequent lienholder has actual knowledge).

56. *See Prestance*, 160 P.3d at 22 (noting that there are three reasons generally given in support of majority approach to equitable subrogation). The court goes on to state that these reasons are unconvincing and elects to adopt the Restatement approach rather than the majority rule. *See id.* at 23 (describing advantages of Restatement approach). *But see Countrywide Home*, 144 P.3d at 1231 (holding that interest in clarity and certainty in land title matters outweighs interest of protecting lending institutions).

57. *Prestance*, 160 P.3d at 22 (explaining that some believe subrogation violates "first in time" rule). The court goes on to state that equitable subrogation could not present much of a threat to the recording acts if jurisdictions allow an ignorant subrogee with constructive knowledge, but not one with actual knowledge. *See id.* at 23 (highlighting that argument for majority approach would deny all application of doctrine).

58. *See id.* at 22 (noting that supporters of majority approach believe that lender should not be allowed to knowingly "leap-frog" another lienholder's prior-

lender cannot reasonably expect to assume first priority lien position when that lender has actual knowledge of an intervening lien with higher priority.[59]

Critics of the majority approach argue that it fosters "willful ignorance," and encourages potential mortgagees to refuse to conduct title searches that may reveal intervening liens.[60] In practice, the majority approach "places a premium on ignorance."[61] In addition, courts use actual notice as an indicator of the refinancing lender's intent to receive priority, rather than the lender's actual intent.[62] Finally, courts rejecting the majority approach contend that it promotes inconsistent applications of the doctrine by precluding subrogation for actual knowledge and not for constructive knowledge.[63]

2. *Minority Approach: No Actual or Constructive Knowledge*

The minority approach, adopted by a small number of states, requires that the refinancing lender not have actual or constructive knowledge of the prior lien.[64] Proponents of this approach believe that mortgage lend-

ity position). Here, the court argues that equitable subrogation maintains the proper scheme of priorities and works to prevent injustice. *See id.* at 23 (citing RESTATEMENT (THIRD) PROP.: MORTGS. § 7.6 cmt. e (1997)).

59. *See id.* ("[L]ender can rarely, if ever, reasonably expect to assume a first-priority position when [it] has actual knowledge of intervening liens."). The court makes clear that the ultimate goal of equitable subrogation is to prevent an intervening lienholder from being unjustly enriched, not inferring on a lender's intent when issuing loan. *See id.* (discrediting majority approach). *But see Equicredit*, 996 A.2d at 1246 (denying equitable subrogation when defendant had actual knowledge of intervening lien); *Bankers Trust*, 124 S.W.3d at 579 (denying equitable subrogation without fraud or mistake); *Homeside Lending*, 2001 UT App 247, at ¶¶ 21–27 (requiring mistake or fraud to apply equitable subrogation).

60. *See* Foster v. Porter Bridge Loan Co., 27 So. 3d 481, 486 (Ala. 2009) ("Critics of the majority view contend it fosters willful ignorance by encouraging prospective mortgagees to forgo conducting title searches so that they might later claim lack of actual knowledge."); *see also* Nelson & Whitman, *supra* note 16, at 315 (noting that refinancing lender can preserve right to subrogation by avoiding knowledge); Smith, *supra* note 47, at 513–14 (arguing that majority approach misplaces emphasis on actual notice instead of lender's intent to receive priority position).

61. See Nelson & Whitman, *supra* note 16, at 315 (arguing that refraining from examining title becomes rational step under this approach).

62. *See* Smith, *supra* note 47, at 513–14 (noting that inference to lender's intent is unnecessary under Restatement approach). The Restatement provides the lender with the opportunity to provide evidence to demonstrate actual intent. *See id.* at 514 (explaining that under Restatement approach lender may prove its intent to get priority).

63. *See Prestance*, 160 P.3d at 23 ("[E]quitable subrogation cannot be said to present too great a threat to the recording act scheme if jurisdictions are willing to allow an ignorant subrogee with only constructive knowledge to come before a prior recorded interest.").

64. *See* Harms v. Burt, 40 P.3d 329, 332 (Kan. Ct. App. 2002) ("'[I]t is negligence for a purchaser of either real or personal property to make the purchase without ascertaining the facts shown by the records which may affect the title to be

ers and other sophisticated businesses should be held to a higher standard when determining lien position, and that they should not be rewarded for failing to properly execute a title search.[65] Nevertheless, this approach has been widely criticized for eliminating the doctrine of equitable subrogation entirely and obviating its underlying purpose.[66] Very few courts continue to apply the minority rule because it precludes equitable subrogation in most cases, especially with regard to mortgage refinancing.[67] Critics argue that the minority approach fails to serve the primary purpose of equitable subrogation—protecting the interests of refinancing lenders who are unintentionally subordinated to an intervening lien.[68] Accordingly, if an intervening lien is of record, then the refinancing lender must have constructive notice under most states' recording acts.[69] Therefore, the only time equitable subrogation would apply is in cases where fraud or

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acquired.'" (quoting Kuhn v. Nat'l Bank of Holton, 87 P. 551, 552 (Kan. 1906))); Mortg. Elec. Registration Sys., Inc. v. Roberts, 366 S.W.3d 405, 409 (Ky. 2012) (affirming *Wells Fargo* rule, which permits actual or constructive knowledge to preclude equitable subrogation); Wells Fargo Bank v. Commonwealth, 345 S.W.3d 800, 810 (Ky. 2011) (holding that equitable subrogation should not be granted to lender that had constructive notice of intervening lien). The Kansas Court of Appeals held in *Harms* that, absent fraudulent conduct, a lender is presumed to have knowledge of all facts that the records disclose. *See Harms*, 40 P.3d at 332 (advocating minority approach).

The Missouri Supreme Court described equitable subrogation as a "fairly drastic remedy . . . allowed only in extreme cases 'bordering on if not reaching the level of fraud.'" Ethridge v. TierOne Bank, 226 S.W.3d 127, 134 (Mo. 2007) (en banc) (quoting Thompson v. Chase Manhattan Mortg. Corp., 90 S.W.3d 194, 206 (Mo. Ct. App. 2002)).

65. *See Wells Fargo*, 345 S.W.3d at 807 (holding that professional mortgage lenders should be held to higher standard for purposes of determining whether lender acted under justifiable or excusable mistake when improperly investigating prior liens).

66. *See Prestance*, 160 P.3d at 21–22 ("For practical purposes, this rule swallows the doctrine and is widely criticized."); *see also Wells Fargo*, 345 S.W.3d at 807 (noting that critics have seen approach as "obviating the doctrine completely"); Nelson & Whitman, *supra* note 16, at 315–16 ("We have vigorously criticized this approach and find it impossible to understand in light of the fact that subrogation in this situation harms no one, leaving the intervening lien exactly where it started." (footnote omitted)).

67. *See Prestance*, 160 P.3d at 21 ("'If all persons who negligently confer an economic benefit upon another are disqualified from equitable relief because of their negligence, then the law of restitution, which was conceived in order to prevent unjust enrichment, would be of little or no value.'" (quoting *Ex parte* AmSouth Mortg. Co., 679 So. 2d 251, 255 (Ala. 1996))). *But see Roberts*, 366 S.W.3d at 409 (denying equitable subrogation based on constructive notice); Mill Creek Lumber & Supply Co. v. First United Bank & Trust Co, 2012 OK CIV APP 53, ¶¶ 16–20, 278 P.3d 12, 16 (holding that constructive notice precluded equitable subrogation).

68. *See Prestance*, 160 P.3d at 22 ("This rule renders equitable subrogation nearly useless since a refinancing mortgagee will almost always have either actual or constructive knowledge of junior lienholders.").

69. *See id.* (noting that equitable subrogation has little use when there are no junior lienholders because plaintiff is only party with interest in property, in which case lender's priority is immaterial).

deceit is present.[70] This is an extremely narrow application of an important equitable doctrine.[71] For this reason, most jurisdictions have stopped using this approach.[72]

3. *Third Restatement Approach: "To the Extent Necessary to Prevent Unjust Enrichment"*[73]

A number of states that apply equitable subrogation in a more liberal manner have adopted the Third Restatement approach or a near equivalent.[74] The Restatement instructs that "[o]ne who fully performs an

70. *See id.* (concluding that under minority approach, equitable subrogation is only applicable when mortgagor fraudulently hides junior interest).

71. *See id.* (noting that cases in which mortgagor fraudulently hides junior lien interest are extremely rare).

72. *But see Roberts*, 366 S.W.3d at 409 (noting majority approach, but following rule established in *Wells Fargo*); *Wells Fargo Bank v. Commonwealth*, 345 S.W.3d 800, 810 (Ky. 2011) (applying minority approach); *Mill Creek Lumber*, 278 P.3d at 16 (following minority approach).

73. RESTATEMENT (THIRD) OF PROP.: MORTGS. § 7.6(a) (1997).

74. *See, e.g.*, Sourcecorp, Inc. v. Norcutt, 274 P.3d 1204, 1207 (Ariz. 2012) (en banc) (adopting Third Restatement approach to equitable subrogation because it is most consistent with rationale of doctrine); Bank of N.Y. v. Nally, 820 N.E.2d 644, 653–54 (Ind. 2005) (adopting Restatement approach in context of conventional refinancing and finding that actual or constructive knowledge did not bar equitable subrogation); Fin. Ctr. Fed. Credit Union v. Brand, 967 N.E.2d 1080, 1085 (Ind. Ct. App. 2012) (following precedent established in *Nally* and holding that refinancing lender can be subrogated unless culpably negligent); E. Boston Sav. Bank v. Ogan, 701 N.E.2d 331, 334 (Mass. 1998) (applying Restatement approach, which grants equitable subrogation "to the extent necessary to prevent unjust enrichment"); CitiMortgage, Inc. v. Mortg. Elec. Registration Sys., Inc., 813 N.W.2d 332, 334 (Mich. Ct. App. 2011) (finding that case law in Michigan was consistent with Restatement approach with regard to refinancing); Houston v. Bank of Am. Fed. Sav. Bank, 78 P.3d 71, 74 (Nev. 2003) (adopting Restatement approach, finding it most persuasive out of all three approaches to equitable subrogation); *Prestance*, 160 P.3d at 29 (adopting Restatement approach in context of conventional refinancing, holding that equitable subrogation applied regardless of actual or constructive knowledge); *see also* Lawyers Title Ins. Corp. v. Feldsher, 49 Cal. Rptr. 2d 542, 550 (Ct. App. 1996) (noting that actual knowledge does not automatically preclude subrogation, but inexcusable negligence prejudiced intervening lienholder); Land Title Ins. Corp. v. Ameriquest Mortg. Co., 207 P.3d 141, 145 (Colo. 2009) (en banc) (citing Restatement approach, noting that neither actual nor constructive notice is dispositive in equitable subrogation analysis, but that prejudice does preclude its application); United Cmty. Bank v. Prairie State Bank & Trust, 972 N.E.2d 324, 339 (Ill. App. Ct. 2012) (holding that omission of encumbrance from exceptions in title insurance policy did not defeat title insurer's right to equitable subrogation); Lasalle Bank Nat'l Ass'n v. White, 246 S.W.3d 616, 619 (Tex. 2007) (noting that equitable subrogation protects homestead property, and without it, lenders would be hesitant to refinance homestead property); Wachovia Mortg. FSB v. Dallas, 2011 WI App 54, ¶¶ 6–8, 332 Wis. 2d 426, 429–31, 797 N.W.2d 930, 932 (granting equitable subrogation so as to prevent unjust enrichment).

Some courts have not adopted the Restatement approach entirely, but apply a method that balances the equities and seeks to prevent unjust enrichment. *See, e.g.*, Rush v. Alaska Mortg. Grp., 937 P.2d 647, 650 (Alaska 1997) (applying "unjust enrichment" standard and noting that actual knowledge was not dispositive in eq-

obligation of another, secured by a mortgage, becomes by subrogation the owner of the obligation and the mortgage to the extent necessary to prevent unjust enrichment."[75] Further, the Restatement provides specific examples of where subrogation is appropriate in the context of mortgage refinancing: (1) in order to protect interest in property; (2) under legal duty; (3) because of misrepresentation, mistake, duress, undue influence, deceit, or other imposition; or (4) upon the request of the obligor.[76] The Restatement specifically provides a diverse range of circumstances where subrogation is available in order to prevent unjust enrichment and encourage application of the doctrine.[77] Moreover, the Restatement does not allow actual or constructive knowledge to preclude the application of equitable subrogation.[78] Rather, it permits the doctrine to apply as justice requires, allowing it to serve its equitable purpose.[79] The drafters of the Third Restatement note that in most cases equitable subrogation prevents an unwarranted and unjust windfall, and should therefore be applied broadly.[80]

B. *Pennsylvania's Application of the Equitable Subrogation Doctrine*

Pennsylvania courts have consistently recognized the doctrine of equitable subrogation, but have applied it in a relatively conservative man-

uitable subrogation matter). The *Rush* court applied a two-part test for equitable subrogation: "(1) whether there was an intent to subordinate the new deed of trust and (2) whether paramount equities favor the junior creditor." *See id.* at 651.

75. RESTATEMENT (THIRD) OF PROP.: MORTGS. § 7.6(a) (1997) (noting that discharge of obligation would also discharge mortgage, but that lien position is preserved in hands of subrogee).

76. *See id.* § 7.6(b) (illustrating different circumstances where subrogation is appropriate to prevent unjust enrichment).

77. *See id.* § 7.6 cmt. a (noting that equitable subrogation is designed to avoid person receiving unearned windfall at expense of another).

78. *See id.* § 7.6 cmt. e ("Under this Restatement, however, subrogation can be granted even if the payor had actual knowledge of the intervening interest; the payor's notice, actual or constructive, is not necessarily relevant.").

79. *See id.* (finding that question under Restatement does not look to notice, but instead whether payor reasonably expected to get security with priority equal to mortgage being paid).

80. *See id.* § 7.6 cmt. a (concluding that intervening lienholders are not prejudiced by subrogation because they are no worse off than before senior obligation was discharged). Furthermore, the drafters explain that without subrogation the junior interest would be promoted undeservedly, giving them an "unwarranted and unjust windfall." *See id.* (justifying broad application of equitable subrogation).

ner.[81] In *Campbell v. Foster Home Ass'n*,[82] the Supreme Court of Pennsylvania established the state's approach to equitable subrogation.[83] There, the defendant paid off a prior mortgage for $6,000 with the proceeds of another mortgage loan.[84] Nevertheless, the court found that the defendant was acting as a volunteer because he had no interest in the property, and the plaintiff had no knowledge of the debt being paid off.[85] Furthermore, the court noted that the payment was not made under compulsion, and if subrogation was granted it would exist in every case of "officious payment of the debt of another."[86] Since *Campbell*, Pennsylvania courts have consistently denied equitable subrogation based on the so-called "volunteer doctrine."[87] While other states have moved away from

81. *See, e.g.*, *In re* Commonwealth Trust Co. of Pittsburgh, 93 A. 766, 768–69 (Pa. 1915) (holding that doctrine of equitable subrogation did not apply in favor of mere volunteer, when no contract existed between parties); Campbell v. Foster Home Ass'n, 30 A. 222, 224–25 (Pa. 1894) (finding that payment of prior mortgage was act of volunteer, and thus equitable subrogation was unavailable); Appeal of Forest Oil Co., 12 A. 442, 443–44 (Pa. 1888) (refusing petition for subrogation as petitioner brought claim late and did not allege sufficient facts); 1313466 Ontario, Inc. v. Carr, 954 A.2d 1, 4–5 (Pa. Super. Ct. 2008) (finding that *Heller* and *Home Owners'* are still binding precedent, and that party seeking intervention was volunteer under Pennsylvania's equitable subrogation doctrine); Home Owners' Loan Corp. v. Crouse, 30 A.2d 330, 332 (Pa. Super. Ct. 1943) (holding that plaintiff was stranger to defendant and voluntary agent with no interest in property); *see also* Fiore, *supra* note 26, at 139 (summarizing equitable subrogation approach applied in Pennsylvania).

82. 30 A. 222 (Pa. 1894).

83. *See id.* at 224 (holding that subrogation was not available because payment of prior mortgage was act of mere volunteer). The court went on to state that "[w]hile subrogation is founded on principles of equity and benevolence . . . it will not be decreed in favor of a mere volunteer, who, without any duty, moral or otherwise, pays the debt of another." *Id.* at 225 (noting that equitable subrogation "will not arise in favor of a stranger, but only in favor of a party who, on some sort of compulsion, discharges a demand against a common debtor").

84. *See id.* at 224 (explaining that issue was whether equitable subrogation applied in favor of appellant).

85. *See id.* at 225 (holding that payment of $6,000 was not made under compulsion or protection of any rights or interests previously acquired). The court found that the defendant loaned money to remove a prior lien and paid off that lien without the knowledge or consent of plaintiff. *See id.* ("[O]ne who is only a volunteer cannot invoke the aid of subrogation, for such a person can establish no equity."). Finally, the court stated that for a person not to qualify as a "volunteer," that person must have paid upon request, or as surety, or under some compulsion that required protection of a personal right. *See id.* (affirming volunteer prong).

86. *Id.* ("[O]ne who discharges an incumbrance [sic] upon property which he has no interest in having relieved is not thereby subrogated to the rights of the holder of the incumbrance [sic], and the loaning of money to discharge a lien does not subrogate the lender to the rights of the lien holder.").

87. *See, e.g.*, 1313466 Ontario, Inc. v. Carr, 954 A.2d 1, 4 (Pa. Super. Ct. 2008) (discussing volunteer rule); First Commonwealth Bank v. Heller, 863 A.2d 1153, 1159 (Pa. Super. Ct. 2004) ("One who is under no legal obligation or liability to pay a debt and who has no interest in, or relation to, the property is a stranger or volunteer with reference to the subject of subrogation." (quoting Home Owners' Loan Corp. v. Crouse, 30 A.2d 330, 331 (1943))).

this approach, Pennsylvania remains on the more conservative end of the equitable subrogation spectrum.[88] Pennsylvania maintains a four-part approach, requiring that: "(1) the claimant paid the creditor to protect his own interest; (2) the claimant did not act as volunteer; (3) the claimant was not primarily liable for the debt; and (4) allowing subrogation will not cause injustice to the rights of others."[89] Under Pennsylvania recording law, the mortgage recorded first holds priority and thus will recover proceeds first upon foreclosure.[90]

Subsequent case law in Pennsylvania has enforced the equitable subrogation standard and preserved the four-part test.[91] After *Campbell*, the Superior Court further clarified the volunteer rule in *Home Owners' Loan Corp. v. Crouse*,[92] holding that there was no right to assert equitable subrogation to a lender with no legal obligation or interest in the property.[93] In *Home Owners'*, a husband and wife took out a loan to pay off all prior encumbrances on their home, but failed to pay off a judgment lien.[94] While

88. *Compare Carr*, 954 A.2d at 4 (denying equitable subrogation because of volunteer rule), *with* Sourcecorp, Inc. v. Norcutt, 274 P.3d 1204, 1208 (Ariz. 2012) (holding that doctrine of equitable subrogation should not turn on whether lender is volunteer).

89. *See Heller*, 863 A.2d at 1158 (holding that refinancing lender was volunteer who could not adopt primary position); *see also* Tudor Development Grp., Inc. v. U.S. Fid. & Guar. Co., 968 F.2d 357, 362 (3d Cir. 1992) (finding that bank that satisfied its own primary liability rather than that of another could not invoke doctrine of equitable subrogation).

90. *See* 42 PA. CONS. STAT. ANN. § 8141(1) (West 1978) (defining "purchase money mortgage" as mortgage taken to secure payment of all or part of purchase price); Pennsylvania is a race notice jurisdiction with regard to recording statutes, which means that purchase money mortgages have priority "from the time they are delivered to the mortgagee, if they are recorded within ten days after their date; otherwise, from the time they are left for record." *Id.*; see also 21 PA. CONS. STAT. ANN. § 622 (West 1927) ("[A]ll mortgages, or defeasible deeds in the nature of mortgages . . . shall have priority according to the date of recording").

91. *Compare* Campbell v. Foster Home Ass'n, 30 A. 222, 225 (Pa. 1894) (holding that second position lienholder, that paid off first position lien, was mere volunteer in making such payment, and not entitled to subrogation), *with* Home Owners' Loan Corp. v. Crouse, 30 A.2d 330, 331 (Pa. Super. 1943) ("One who is under no legal obligation or liability to pay a debt and who has no interest in, or relation to, the property is a stranger or volunteer with reference to the subject of subrogation.").

92. 30 A.2d 330 (Pa. Super. Ct. 1943).

93. *See id.* at 331 ("A mere volunteer or intermeddler who, having no interest to protect, without any legal or moral obligation to pay, and without an agreement for subrogation, or an assignment of the debt, pays the debt of another is not entitled to subrogation . . . ."). The *Home Owners'* court noted that the payor must have acted out of "compulsion," which only occurs when the lienholder is forced to pay in order to protect his or her interests. *See id.*

94. *See id.* (noting that couple intended to pay liens against their home with loan from Home Owners', but failed to recognize one outstanding judgment lien). The court explained that Home Owners' had no knowledge of the intervening lien and assumed that it would have priority lien position on the property. *See id.* (discussing Home Owners' request to intervening lienholder to subordinate its lien, but intervening lienholder refused to do so).

the homeowners disclosed all other liens, they failed to disclose the judgment lien, which put the lender in a secondary lien position.[95] The court held that the refinancing lender could not subrogate to the position of the intervening lienholder because it was not required to pay the prior debts.[96] Furthermore, the court found that granting subrogation in favor of Home Owners' would prejudice the intervening lienholder.[97] Ultimately, the court recognized that the majority of Pennsylvania's sister states did not apply this standard, but stood by its reasoning that the lender was a volunteer.[98]

III. *FIRST COMMONWEALTH BANK V. HELLER*: PENNSYLVANIA REFUSES TO PUT EQUITABLE SUBROGATION FIRST

The Superior Court's decision in *Heller* reaffirmed the equitable subrogation precedent in Pennsylvania.[99] The court continued to apply the antiquated volunteer rule, thus precluding the application of the doctrine in the refinancing context.[100] This decision will have dramatic effects on both homeowners and lenders as the housing market begins to rebound.[101]

95. *See id.* at 331 (noting that homeowners set forth all liens that encumbered property, but made no reference to outstanding judgment lien for $682.50, leaving lender unaware). The court recognized that the lender was likely without knowledge of the judgment lien, but the intervening lienholder refused to subordinate its loan. *See id.* (finding that Home Owners' loan was subordinate).

96. *See id.* at 332 (holding that Home Owners' was stranger to borrowers that had no legal obligation or compulsion to pay borrowers' debts). Therefore, the refinancing lender was a voluntary agent with no interest in the property, and it could agree or refuse to make the loan as it pleased. *See id.*

97. *See id.* (stating that Home Owners' negligence in failing to adequately search public records caused them to be unaware of intervening lien). In addition, the court held that "courts of equity will not relieve a party from the consequences of an error due to his own ignorance or carelessness when there were available means which would have enabled him to avoid the mistake if reasonable care had been exercised." *Id.* (denying equitable subrogation).

98. *See id.* ("Subrogation, being of equitable origin and nature, may be resorted to only when one has an equity to invoke which does not injure an innocent party."). The court found that Home Owners' subrogation would unjustly prejudice the intervening lienholder, and thus would injure an innocent party. *See id.*

99. *See id.* (applying four-part test for equitable subrogation and holding that equitable subrogation did not apply to refinancing mortgagee).

100. *See id.* (finding that refinancing mortgagee was volunteer).

101. *See* Stiglitz & Zandi, *supra* note 6 (noting that mass refinancing would allow homeowners to drastically reduce their monthly payments and significantly reduce chance of default).

A. *Facts and Procedure: A Difficult Situation for All Parties Involved*

In *Heller*, defendant Catharine Heller, like many homeowners, sought to refinance multiple mortgages on her home.[102] When purchasing her home in 1990, Heller took out a loan from Central Bank, which she secured with a mortgage.[103] In addition, Heller obtained a line of credit from Mid-State Bank in the amount of $15,000.[104] Next, Heller received a large loan from First Commonwealth Bank.[105] In 2000, First Commonwealth granted Heller a loan to refinance her prior loan.[106] Shortly after, Heller received a loan from Ameriquest for $119,000.[107] Heller used the Ameriquest loan to pay off the Central Bank loan and the Mid-State line of credit.[108] Nevertheless, the $15,000 line of credit remained open, and Heller never paid off the remaining First Commonwealth loan.[109] At the time Ameriquest extended its loan to Heller, three mortgages encumbering the property were on public record.[110] However, due to a faulty title search, Ameriquest failed to uncover First Commonwealth's mortgage.[111]

102. *See Heller*, 863 A.2d at 1154 (explaining that Heller received three loans and one line of credit, which were all secured by mortgage on real property titled in her name).

103. *See id.* (explaining that Central Bank, predecessor to plaintiff, extended loan to Heller for $73,170, which she secured with mortgage on her home).

104. *See id.* (noting that Mid-State Bank extended $15,000 line of credit in February 1995).

105. *See id.* (noting that in March 1990, Central Bank, predecessor to First Commonwealth, extended loan in amount of $73,170 to Heller). Also, Heller opened up a line of credit in 1995 from Mid-State Bank. *See id.*

106. *See id.* (explaining that Heller received loan from First Commonwealth in 2000 for $76,680.26, which she used to pay off her 1997 loan). The 1997 loan was also from First Commonwealth. *See id.*

107. *See id.* (detailing Ameriquest's August 2001 loan for amount of $119,000, which Heller used to pay off Central Bank's 1990 loan, and Mid-State's 1995 line of credit).

108. *See id.* (acknowledging that proceeds of 2001 loan were used to pay off Central Bank's 1990 loan and Mid-State's 1995 line of credit, but the latter remained open).

109. *See id.* (noting that public records would have revealed three mortgages on property at time of loan). Further, the court explained that the mortgage securing the 1995 line of credit remained open, thus, the mortgage remained of record. *See id.* Further, a title search executed at the time the 2001 loan was issued would have revealed all three loans encumbering the property. *See id.* (referring to 1990, 1995, and 2000 mortgages).

110. *See id.* (noting that in August 2001, when Ameriquest extended $119,000 loan, public records would have revealed three mortgages on Heller's property). Specifically, Ameriquest could have determined that the (1) Central Bank 1990 Mortgage, (2) Mid-State 1995 Mortgage, and (3) First Commonwealth's 2000 Mortgage were all encumbering the property. *See id.*

111. *See id.* (explaining that Ameriquest recognizes three mortgages existed at time of loan, but admits that title search did not reveal existence of First Commonwealth's 2000 mortgage). The court also noted that the Mid-State line of credit remained open and First Commonwealth's loan was unsatisfied, so Ameriquest's 2001 Mortgage was now in third position for recovery in foreclosure. *See id.*

Accordingly, First Commonwealth's loan and Mid-State's line of credit remained on the property, while Ameriquest's lien fell to third position.[112]

In 2003, Heller defaulted on her First Commonwealth loan, and the bank initiated a foreclosure action against her.[113] In order to preserve its interest in Heller's property, Ameriquest filed a petition to intervene.[114] Ameriquest sought relief under the theory of equitable subrogation, arguing that it should have taken the lien position of the Central Bank loan.[115] Nevertheless, the court denied this petition, holding that Ameriquest's negligence caused its failure to uncover First Commonwealth's mortgage.[116] Ameriquest appealed to the Superior Court of Pennsylvania, which affirmed the trial court's decision.[117] The court held that Ameriquest was a volunteer to the transaction, and it had no obligation to pay Heller's prior loans.[118] Therefore, Ameriquest could not be subrogated to Central Bank's lien position; rather, it was relegated to third lien position.[119] Thus, Ameriquest, which rightfully expected to take a priority lien position, was now unjustly made a junior lien.[120]

B. *The Superior Court's Decision in* Heller*: Following Precedent to Nowhere*

The court in *Heller* noted that the priority of a lien is generally determined by the date it was recorded, but that equitable subrogation is a "widely-recognized exception to the 'first in time' rule."[121] The court re-

112. *See id.* at 1154 (recognizing two mortgages of record that encumbered property prior to Ameriquest's 2001 refinancing loan). The trial court asserted that Ameriquest's loss of priority resulted from its own negligence in failing to discover First Commonwealth's mortgage. *See id.*

113. *See id.* ("On March 5, 2003, First Commonwealth Bank filed the instant foreclosure action based upon its April 2000 loan."). While the actual action is between First Commonwealth and Heller, Ameriquest unsuccessfully attempted to file a petition to intervene as an interested party. *See id.*

114. *See id.* (acknowledging that appellant Ameriquest filed petition to intervene on June 10, 2003, two months after First Commonwealth had filed its foreclosure action). After Ameriquest's petition was denied and summary judgment entered against Heller, the court issued a writ of execution to foreclose on Heller's home. *See id.* The trial court granted a stay on the sheriff's sale, but after holding a hearing on Ameriquest's petition, the court denied petition and vacated the stay. *See id.* Finally, the trial court entered an opinion explaining that Ameriquest did not have the right to equitable subrogation because negligence caused it to be in the secondary lien position. *See id.* at 1155.

115. *See id.* (noting appellant's petition to intervene).

116. *See id.* (explaining that trial court held appellant's negligence resulted in failing to discover First Commonwealth's mortgage).

117. *See id.* at 1160 (denying Ameriquest's petition to intervene).

118. *See id.* (holding that Ameriquest was not entitled to equitable subrogation and was therefore subordinate to First Commonwealth's mortgage).

119. *See id.* at 1155 (describing trial court's decision to deny equitable subrogation).

120. *See id.* at 1154 (illustrating that three mortgages remained on Heller's property, two of which held priority to Ameriquest's mortgage).

121. *Id.* at 1156 (noting that doctrine of equitable subrogation is recognized in Pennsylvania as an exception to the Pennsylvania recording act).

lied heavily on the precedent established in *Home Owners'*, where the court found that the refinancing lender was a volunteer because it was a stranger to the borrower and had no legal obligation to pay the borrower's debts.[122] In addition, the court in *Home Owners'* held that "courts of equity will not relieve a party from the consequences of an error due to his own ignorance or carelessness."[123] The court in *Heller* held that the facts were "practically indistinguishable" from those presented in *Home Owners'*.[124]

In *Heller*, the court applied the four-part test that is well-established in Pennsylvania.[125] Of the four criteria, the court focused particularly on whether Ameriquest was acting as a volunteer when refinancing Heller's loans.[126] The court noted that courts should be inclined to "favor and further" equitable subrogation, but that it requires more than "mere payment of a debt" to entitle a person to subrogation.[127] Following the precedent established in *Home Owners'*, the court affirmed that "[a] mere volunteer or intermeddler who, having no interest to protect, without any legal or moral obligation to pay" is not entitled to equitable subrogation.[128] Furthermore, the court quoted *Home Owners'* stating that "[o]ne

122. *See id.* at 1159 (holding that refinancing mortgagee was not entitled to equitable subrogation because it was volunteer) (quoting Home Owners' Loan Corp. v. Crouse, 30 A.2d 330, 331 (Pa. Super. Ct. 1943)). In *Home Owners'*, the court held that it "requires something more than the mere payment of a debt in order to entitle the person paying the same to be substituted in place of the original creditor." *Id.* (denying equitable subrogation).

123. *Home Owners'*, 30 A.2d at 332 (noting that Home Owners' negligence in failing to properly search public records caused unawareness of intervening judgment lien).

124. *Heller*, 30 A.2d at 1160 ("The trial court therefore properly found [that Ameriquest] was not entitled to the remedy of equitable subrogation."). In *Home Owners'*, a creditor paid various earlier liens on the homeowner's property, but was unaware of an intervening judgment lien. *Home Owners'*, 30 A.2d at 331. The creditor requested subordination, but the lienholder refused. *See id.* After analogizing the facts of *Home Owners'* to the case before the court, it found that the creditor was a mere volunteer and, as such, was not entitled to subrogation. *See Heller*, 30 A.2d at 1158–59 (citing *Home Owners'*, 30 A.2d at 331).

125. *See Heller*, 30 A.2d at 1158 (explaining four criteria that must be satisfied for equitable subrogation to apply). Pennsylvania establishes four requirements for claim of equitable subrogation: "(1) the claimant paid the creditor to protect his own interests; (2) the claimant did not act as volunteer; (3) the claimant was not primarily liable for the debt; and (4) allowing subrogation will not cause injustice to the rights of others." *Id.*

126. *See id.* (holding that under Pennsylvania law, appellant did not meet four criteria for equitable subrogation).

127. *Id.* at 1159 (quoting Home Owners' Loan Corp. v. Crouse, 30 A.2d 330, 331 (1943)) (explaining that to be entitled to equitable subrogation, party's equity should be strong and superior to opposing party).

128. *Id.* (quoting Home Owners' Loan Corp. v. Crouse, 30 A.2d 330, 331 (1943)) (explaining limited circumstances in which person paying debt of another is entitled to subrogation under Pennsylvania law). The court explained:

> The payor must have acted on compulsion, and it is only in cases where the person paying the debt of another will be liable in the event of a default or is compelled to pay in order to protect his own interests, or by virtue of legal process, that equity substitutes him in the place of the cred-

who is under no legal obligation or liability to pay a debt and who has no interest in, or relation to, the property is a stranger or volunteer with reference to the subject of subrogation."[129] Finally, the court found that granting subrogation would prejudice the rights of the intervening lienholder.[130]

The outcome in *Heller* was the product of overreliance on antiquated precedent.[131] In *Heller*, the court found that Ameriquest did not have an independent interest in Heller's property and was not compelled to satisfy her mortgages.[132] Furthermore, it held that Ameriquest was not entitled to equitable subrogation and held a subordinate lien position to First Commonwealth.[133] Nevertheless, the court recognized that the decision in Home Owners', and thus this decision, was "*not in accord* with the Restatement or with the case law of *many* of our sister states."[134]

C. *Critical Analysis: The Court in* Heller *Defeats Purpose of Equitable Subrogation*

The court in *Heller* maintained Pennsylvania's tradition of restrictive application of equitable subrogation.[135] First, the court reestablished the overly burdensome volunteer rule, finding that one seeking equitable subrogation must not be a volunteer.[136] Second, it failed to address actual or

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itor without any agreement to that effect; in other cases the debt is absolutely extinguished.

Id. (quoting Home Owners' Loan Corp. v. Crouse, 30 A.2d 330, 331 (1943)).

129. *Id.* (noting that lender was "an entirely voluntary agent with no interest in the property and at liberty to make its own bargain-agree or refuse to make its loan as it saw fit." (quoting Home Owners' Loan Corp. v. Crouse, 30 A.2d 330, 332 (1943))). Further, the court found that subrogation would prejudice the rights of the intervening lienholder and that the lender's negligence ultimately caused the loss of priority. *See id.*

130. *See id.* (holding that courts of equity will not relieve party from errors caused by its own ignorance or carelessness). The court noted that reasonable care would have allowed Home Owners' to avoid the mistake. *See id.* (explaining that negligence caused lender to fail to discover intervening lien).

131. *See Heller*, 863 A.2d at 1159 (noting that court in *Home Owners'*, decided over sixty years earlier, applied principles of equity and fairness and denied creditor equitable subrogation).

132. *See id.* at 1159–60 (noting that lender in *Home Owners'* was under no legal obligation or compulsion to pay homeowner's debts).

133. *See id.* at 1160 (holding that appellant was not entitled to equitable subrogation, and that its lien was subordinate to that of appellee).

134. *Id.* at 1159–60 (emphasis added) (footnote omitted) (noting that *Home Owners'* was not overruled and remains binding precedent). Furthermore, the court found that the facts were practically indistinguishable from *Home Owners'*. *See id.*

135. *See id.* at 1160 (denying equitable subrogation to refinancing lender).

136. *See id.* (holding that refinancing lender was volunteer).

constructive notice.[137] Third, the court applied a negligence standard that limits the fundamental purpose of the doctrine.[138]

1. *Pennsylvania's Precedent Puts Refinancing Lenders Last*

While the court in *Heller* followed the precedent established in *Home Owners'*, its approach defeats the purpose of equitable subrogation.[139] The volunteer rule that Pennsylvania applies is inoperably strict.[140] Moreover, the rule greatly increases the risk of harm that refinancing lenders face when issuing a loan to pay off a prior mortgage.[141] In *Heller*, the court found that Ameriquest was a volunteer.[142] Such a holding prevents refinancing lenders from asserting a right of equitable subrogation in Pennsylvania.[143] For this reason, many courts outside of Pennsylvania interpret the volunteer rule liberally or have eliminated it altogether.[144] The Restatement eliminates the volunteer rule, recognizing that it is "highly variable and uncertain," and causes "considerable confusion."[145] When strictly applied, the volunteer rule places the entire burden on refinancing lenders.[146] Noting the importance of equitable subrogation in the context of refinancing, it seems counterintuitive to prevent refinancing lenders from taking advantage of such a valuable doctrine.[147]

137. *See id.* at 1154 (noting that Ameriquest was unaware of prior lien).

138. *See id.* at 1155 (disfavoring equitable subrogation because mistake resulted from appellant's negligence).

139. *See* GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW, PRACTITIONER SERIES § 10.4 (3d ed. 1994) (discussing and disparaging volunteer rule); *see also Subrogation*, *supra* note 44, at 684–85 (noting that in legal subrogation class of persons included within term "volunteer" has been reduced).

140. *See* Winiarski, *supra* note 23, at 236 (arguing that voluntary actor and volunteer are not synonymous). In Connecticut "one may act voluntarily without being deemed a 'volunteer.'" *Id.*

141. *See* Mosson, *supra* note 42, at 721 (explaining that some courts define volunteer like gift givers, while others exclude voluntary commercial actors).

142. *See Heller*, 863 A.2d at 1160 (denying equitable subrogation to refinancing lender).

143. *See* RESTATEMENT (THIRD) PROP.: MORTGS. § 7.6 cmt. b (1997) (noting that Restatement does not adopt "volunteer" rule, but rather requires that subrogee "pay to protect some interest").

144. *See* Mosson, *supra* note 42, at 721 (finding that many courts define "'mere volunteers' more widely, thus excluding voluntary commercial actors, like refinancers with no stake in prior loans"); *see also Subrogation*, *supra* note 44, at 686 (finding that there is no general agreement for definition of volunteer, but minority of courts define it as one "who did not have some previous interest to protect").

145. RESTATEMENT (THIRD) OF PROP.: MORTGS. § 7.6 cmt. b (1997) (noting that prior case law has indicated that "volunteer" is not entitled to subrogation, but refusing to adopt this requirement). The Restatement only requires that subrogee pay to protect an interest, which eliminates the volunteer rule. *See id.*

146. *See Subrogation*, *supra* note 44, at 686 ("A minority of courts is prone to call everyone a volunteer who was not in the position of a surety or who did not have some previous interest to protect in the subject matter in question.").

147. *See* Yoo, *supra* note 15, at 2136 ("Homeowners typically seek to refinance when interest rates on new mortgages are lower than interests rates on existing mortgage loans, or when they are in need of additional capital.").

2. *Court Promotes the Volunteer Rule, But Fails to Address Actual or Constructive Notice*

Although the court in *Heller* did not explicitly address actual or constructive knowledge within the opinion, it indicated that Ameriquest's title search did not reveal the existence of First Commonwealth's mortgage.[148] Assuming that this is true, as the court did, Ameriquest did not have actual knowledge of the intervening lien.[149] Ameriquest did have constructive notice because First Commonwealth properly recorded its mortgage.[150] Nevertheless, the majority approach does not preclude equitable subrogation for constructive notice, so this would not be determinative in Pennsylvania.[151] Interestingly, the court in *Heller* did not analyze Ameriquest's knowledge of the prior lien, which is the focal point in most jurisdictions.[152] Instead, the court placed enormous significance on the volunteer rule, which makes the doctrine's application in the refinancing context much more difficult.[153] In contrast to Pennsylvania's standard, many jurisdictions allow a request from a homeowner to constitute an interest in the property.[154] Thus, in those jurisdictions, refinancing lenders are not considered strangers when the borrower seeks to refinance.[155] By

148. *See* First Commonwealth Bank v. Heller, 863 A.2d 1153, 1154 (Pa. Super. Ct. 2004) (noting that appellant admitted title search did not reveal intervening lien).

149. *See id.* (explaining that Ameriquest conceded existence of three mortgages, but presumed that failure to find First Commonwealth lien was due to searcher's error).

150. *See id.* (finding that three mortgages remained of record when Ameriquest refinanced Heller's loan).

151. *See* Bank of Am., N.A. v. Prestance Corp., 160 P.3d 17, 21 (Wash. 2007) (en banc) (noting that constructive notice only plays part in minority approach to equitable subrogation).

152. *See, e.g.*, Foster v. Porter Bridge Loan Co., 27 So. 3d 481, 485–86 (Ala. 2009) (holding that constructive notice will not preclude application of equitable subrogation); Equicredit Corp. of Conn. v. Kasper, 996 A.2d 1243, 1246 (Conn. App. Ct. 2010) (holding that equitable subrogation did not apply because plaintiff had actual or constructive notice of defendant's lien); HSBC Bank USA, N.A. v. Mendoza, 11 A.3d 229, 235 (D.C. 2010) ("[A] lender who pays off a pre-existing mortgage and takes a new mortgage as security for the loan will be subrogated to the rights of the first mortgagee as against any intervening lienholders, even if the lender is on constructive notice of the existence of the junior liens.").

153. *See Heller* 863 A.2d at 1158–60 (describing volunteer rule and holding that Ameriquest constituted volunteer under Pennsylvania law).

154. *See* Home Owners' Loan Corp. v. Sears, Roebuck & Co., 193 A. 769, 772 (Conn. 1937) (holding that mortgagee was not volunteer based on agreement with homeowner); *Prestance*, 160 P.3d at 21 (allowing mortgagee to subrogate under Restatement); *see also* RESTATEMENT (THIRD) PROP.: MORTGS. § 7.6(b)(4) (1997) (allowing equitable subrogation "upon a request from the obligor").

155. *See Subrogation*, *supra* note 44, at 686 ("[T]he liberal view leads to the result that the only volunteer would be one who, without an invitation from any other party and purely as a philanthropist, relieved another from an obligation.").

eliminating the volunteer element, Pennsylvania could greatly promote refinancing and protect the interests of both lenders and borrowers.[156]

3. *Court Uses Third Party Negligence to Rule Out Equitable Subrogation*

The negligence standard applied by the court in *Heller* is too strict of a standard for an equitable doctrine.[157] In effect, Pennsylvania law prevents parties from invoking equitable subrogation when prior mortgages did not show up in their title search.[158] Regardless of whether the mistake resulted from third party negligence, the onus falls on the refinancing lender.[159] Following this logic, equitable subrogation would only apply when the intervening lien was not of record.[160]

This philosophy eliminates a majority of circumstances when the equitable doctrine would apply.[161] Furthermore, it encourages refinancing lenders to refuse to refinance prior liens because of the major risk involved.[162] The Restatement recognizes that a strict interpretation of equitable subrogation is not necessary because the intervening lienholder is not adversely affected by subrogation.[163] In other words, the intervening

156. *See* RESTATEMENT (THIRD) OF PROP.: MORTGS. § 7.6 cmt. b (1997) ("The meaning of the term 'volunteer' is highly variable and uncertain, and has engendered considerable confusion.").

157. *See* Starr, *supra* note 22, at 2 (noting that standard for equitable subrogation is "culpable and inexcusable neglect" in failing to protect senior priority position).

158. *See Heller* 863 A.2d at 1155 (defining Ameriquest's "problem" as negligence in title searching).

159. *See Prestance*, 160 P.3d at 21 (explaining that rule that strictly punishes negligence "swallows the doctrine" of equitable subrogation).

160. *See id.* ("If all persons who negligently confer an economic benefit upon another are disqualified from equitable relief because of their negligence, then the law of restitution, which was conceived in order to prevent unjust enrichment, would be of little or no value." (quoting *Ex Parte* AmSouth Mortg. Co., 679 So.2d 251, 255 (Ala. 1996))).

161. *See* RESTATEMENT (THIRD) OF PROP.: MORTGS. § 7.6 cmt. e (1997) ("The most common context for this sort of subrogation is the 'refinancing' of a mortgage loan"); Nelson & Whitman, *supra* note 16, at 315 (describing minority approach to equitable subrogation as "the most hostile to the refinancing lender"). While Pennsylvania does not apply the minority approach, its volunteer rule and negligence standard place the burden on the lender. *See also* Ominsky, *supra* note 26 (noting that lender who extends loan in order to pay off earlier loans is "volunteer" under Pennsylvania law).

162. *See* Nelson & Whitman, *supra* note 16, at 305–06 (arguing that making equitable subrogation available liberally can "eliminate the risk that intervening liens . . . will take priority over refinancing mortgage"). Moreover, the authors posit that adopting the Restatement approach would greatly reduce the need for new title insurance when refinancing. *See id.* (noting advantages of Restatement approach to equitable subrogation).

163. *See* RESTATEMENT (THIRD) OF PROP.: MORTGS. § 7.6 cmt. a (1997) ("The holders of intervening interests can hardly complain about this result, for they are no worse off than before the senior obligation was discharged."); *see also id.* § 7.6 cmt. e (concluding that holders of intervening interests are not materially prejudiced by subrogation in refinancing context).

lienholder is in no worse position because it did not expect to be in a priority position.[164] Therefore, negligence on behalf of an attorney or title searcher should not preclude a lender from taking advantage of equitable subrogation.[165]

IV. WHAT'S NEXT AFTER *HELLER*?: MOVING TOWARD THE RESTATEMENT

Pennsylvania's current precedent establishes an inequitable approach to equitable subrogation.[166] It restricts the doctrine in the refinancing context, thus limiting its most valuable purpose.[167] In order for Pennsylvania to adapt to the changing economic climate, it must adopt the Restatement approach to equitable subrogation.[168]

A. *Pennsylvania Continues to Follow Inequitable Precedent*

Pennsylvania courts continue to follow the precedent established in *Heller*.[169] For example, in *1313466 Ontario, Inc. v. Carr*,[170] the court held that a refinancing lender could not be equitably subrogated to a prior lien position.[171] In *Carr*, Jeffrey Carr, a homeowner, received a loan from U.S. Bank, which he used to pay off three prior loans.[172] Nevertheless, Carr

164. *See id.* § 7.6 cmt. e (explaining that payor will have benefit of subrogation to mortgage that was discharged only if payor was promised repayment of funds and reasonably expected to receive senior mortgage).

165. *See id.* (noting that under Restatement, subrogation can be granted even if payor had actual knowledge of intervening interest). The critical inquiry is "whether the payor reasonably expected to get security with a priority equal to the mortgage being paid." *Id.* Thus, third party negligence should not affect this expectation. *See id.* (stating that "payor's notice . . . is not necessarily relevant").

166. *See, e.g.*, 1313466 Ontario, Inc. v. Carr, 954 A.2d 1, 2 (Pa. Super. Ct. 2008) (providing example of how Pennsylvania's approach precludes homeowners from receiving refinancing loans if there are intervening liens).

167. *See* First Commonwealth Bank v. Heller, 863 A.2d 1153, 1160 (Pa. Super. Ct. 2004) (holding that refinancing mortgagee precluded from equitable subrogation).

168. *See* Nelson & Whitman, *supra* note 16, at 353 (arguing that widespread adoption of Restatement will help both homeowners and lenders).

169. *See Carr*, 954 A.2d at 2 (holding that case was indistinguishable from recent case in *Heller*, and thus bank in question was not entitled to relief under equitable subrogation). The *Carr* court noted that Pennsylvania's interpretation of the doctrine of equitable subrogation places lenders in a dilemma, because if the intervening lienholder refuses to subrogate lien position, the lienholder will not be able to refinance the homeowner's loan. *See id.* at 5–6; *see also* Newcrete Prods. v. City of Wilkes-Barre, 37 A.3d 7, 15 (Pa. Commw. Ct. 2012) (explaining that "Pennsylvania's doctrine allows a party who satisfies an encumbrance to assume the same priority position as the holder of the prior encumbrance" (citing generally First Commonwealth Bank v. Heller, 863 A.2d 1153 (Pa. Super. Ct. 2004))).

170. 954 A.2d 1 (Pa. Super. Ct. 2008).

171. *See id.* at 5 (holding that bank was not entitled to equitable subrogation because it was acting as volunteer).

172. *See id.* at 1–2 (explaining that Carr used U.S. Bank loan to pay off three prior loans). The proceeds of the U.S. Bank loan were used to pay off Lendent and Household loans, and another unsecured loan. *See id.*

failed to satisfy an additional mortgage on the property, of which U.S. Bank was completely unaware.[173] When Carr defaulted on his loan payments, the mortgagee in priority position foreclosed on Carr's home.[174] The intervening lienholder was now threatening U.S. Bank's interest in the property.[175] U.S. Bank petitioned to intervene in the foreclosure action by making an argument for equitable subrogation.[176] However, the court found that U.S. Bank was not entitled to relief because it was a volunteer in the matter and because its own negligence caused it to overlook the intervening lien.[177] The court in *Carr* followed the precedent established in *Home Owners'* and *Heller*, and it reiterated the State's policy on equitable subrogation.[178] Accordingly, Pennsylvania law has been unable to adapt to the changing needs of homeowners, and the increase of refinancing in the current housing market.[179]

B. *The National Trend Toward the Restatement Approach*

Recent state court cases demonstrate a national trend toward adopting the Restatement approach to equitable subrogation.[180] The courts that have adopted the Restatement approach support it because it favors lenders, prevents unjust enrichment, and ensures that secondary lienholders do not receive windfalls.[181] Furthermore, the Restatement allows for uniform application of the doctrine and limits the uncertainty

173. *See id.* at 2 ("U.S. Bank was unaware of the Ontario mortgage due to an error in its title search.").

174. *See id.* (explaining that Carr defaulted on his payments for Ontario mortgage, who then obtained two judgments in mortgage foreclosure).

175. *See id.* (detailing Carr's defaults on his payments and discussing Ontario's subsequent foreclosure action).

176. *See id.* (acknowledging two judgments secured by Ontario in foreclosure actions, in which U.S. Bank sought to intervene).

177. *See id.* at 5 (finding that facts were indistinguishable from *Home Owners'* and *Heller*, and that U.S. Bank constituted volunteer under analysis from both cases).

178. *See id.* (noting that decision was guided by principle of *stare decisis*, but also by U.S. Bank's negligence).

179. *See* Armour, *supra* note 13 (noting that refinancing applications made up about eighty-five percent of all mortgage applications in 2008); *see also* Ominsky, *supra* note 26 (noting that under Pennsylvania law, lender must not have acted as volunteer to be entitled to equitable subrogation).

180. *See, e.g.*, Green v. HSBC Mortg. Servs., Inc. (*In re* Green), 474 B.R. 790, 795 (Bankr. D. Md. 2012) (finding lender that refinanced debtor's obligation on existing, first-priority lien was entitled to be equitably subrogated to rights of first-position lienholder); Citimortgage, Inc. v. Mortg. Elec. Registration Sys., Inc., 813 N.W.2d 332, 336 (Mich. Ct. App. 2011) (holding that "equitable subrogation is available to place a new mortgage in the same priority as a discharged mortgage"); Bank of Am. v. Prestance Corp., 160 P.3d 17, 18 (Wash. 2007) (en banc) (holding that refinancing mortgagee's actual or constructive notice of intervening liens does not prevent application of equitable subrogation).

181. *See Prestance*, 160 P.3d at 18 (adopting Restatement approach to equitable subrogation); *see also* Murray, *supra* note 25, at 255 (noting that court in *Prestance* dismissed argument that Restatement approach "'would obstruct the pre-

and variability of other approaches.[182] Thus, equitable subrogation is more predictable under the Restatement, which only requires that it prevent unjust enrichment.[183] Many states have adopted the Restatement to promote refinancing and curb the threat of foreclosure.[184]

In one such prominent state court case, *Bank of America, N.A. v. Prestance Corp.*,[185] the Washington Supreme Court adopted the Restatement approach to equitable subrogation.[186] In *Prestance*, homeowners took out a loan from Wells Fargo to satisfy multiple prior liens on their home, including a priority lien from Washington Mutual.[187] Wells Fargo believed it would take priority over the other loans that its proceeds were used to satisfy; however, one loan remained that it was not subordinate to.[188] The Washington Supreme Court applied the Restatement approach, finding that Wells Fargo was entitled to subrogate to first priority lien position in the amount of the loan paid off.[189] The *Prestance* court recognized that the Restatement approach was not yet the majority position, but found it to be the most equitable stance.[190] The court concluded that the purpose of equitable subrogation was to prevent a person from

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dictability and stability of the recording act'" (quoting Bank of Am., N.A. v. Prestance Corp., 160 P.3d 17, 22–24 (Wash. 2007) (en banc))).

182. *See* RESTATEMENT (THIRD) PROP.: MORTGS. § 7.6 cmt. a (1997) (concluding that "[s]ubrogation is a broad concept . . . . in which one who performs a mortgage is entitled to subrogation in order to avoid unjust enrichment"). The Restatement approach eliminated the volunteer rule, which it noted caused "considerable confusion." *Id.* § 7.6 cmt. b. Furthermore, the Restatement requires the subrogee to have performed in order to protect some "interest," but not a legally recognized property interest. *See id.* (noting that "a business or financial interest that would be impaired by foreclosure of the mortgage, an interest in reputation, or a moral obligation" would suffice).

183. *See id.* § 7.6(a) ("One who fully performs an obligation of another, secured by a mortgage, becomes by subrogation the owner of the obligation and the mortgage to the extent necessary to prevent unjust enrichment.").

184. *See* Nelson & Whitman, *supra* note 16, at 353 (arguing that widespread adoption of Restatement approach is likely to lead to substantial savings for refinancing homeowners). The article notes a recent trend in courts being favorable to Restatement. *See id.* (noting that continuation of trend is desirable for homeowners who desire to receive substantial savings).

185. 160 P.3d 17 (Wash. 2007) (en banc).

186. *See id.* at 29 (adopting Section 7.6 of Restatement and holding that lender was entitled to equitable subrogation).

187. *See id.* at 19 (explaining that homeowners' applied for million dollar loan from Wells Fargo to pay off their home purchase loan). Wells Fargo approved the million dollar home equity line of credit in December 2001. *See id.* (noting that Wells Fargo secured loan with deed of trust).

188. *See id.* (reporting that Wells Fargo expected to take first lien position on the home).

189. *See id.* at 20 (finding that equitable subrogation preserves proper priorities by keeping first mortgage first and second mortgage second).

190. *See id.* (noting that courts were initially resistant to equitable subrogation, but now many courts apply doctrine liberally).

receiving "an unearned windfall at the expense of another."[191] Furthermore, the court found that the Restatement readily applied in the context of conventional refinancing, which it saw as commonplace in today's economy.[192] Moreover, the court concluded that denying equitable subrogation based on the knowledge of intervening interests "runs contrary to the purposes underlying the doctrine."[193] Ultimately, the court found that the Restatement provided the most equitable and sensible approach, allowing subrogation regardless of actual or constructive knowledge of intervening liens.[194]

More recently, in *Sourcecorp, Inc. v. Norcutt*,[195] the Arizona Supreme Court adopted the Restatement approach.[196] In *Norcutt*, Dean and Stacey Norcutt purchased a home for cash and satisfied the mortgage on the property.[197] However, the couple later discovered that they purchased the home subject to a judgment lien that far exceeded the property's value.[198] Prior to *Norcutt*, Arizona courts applied the same volunteer rule as Pennsylvania.[199] Nevertheless, the court adopted the Restatement approach because of the ambiguity in Arizona case law regarding equitable subrogation.[200] The court found that equitable subrogation should not turn on whether a person invoking the doctrine was labeled a volunteer.[201] Fi-

191. *Id.* at 21 (quoting RESTATEMENT (THIRD) PROP.: MORTGS. § 7.6 cmt. a (1997)) (reasoning that Restatement properly emphasizes equitable subrogation's concern of unjust enrichment).

192. *See id.* at 25 (citing Bank of N.Y. v. Nally, 820 N.E.2d 644, 653 (Ind. 2005)) (agreeing with Restatement approach in context of conventional refinancing). The court noted that refinancing was "common place" in the current economy. *Id.* (quoting Bank of N.Y. v. Nally, 820 N.E.2d 644, 653 (Ind. 2005)) (acknowledging that refinancing lender expects to receive same security as loan being paid off).

193. *Id.* (quoting Bank of N.Y. v. Nally, 820 N.E.2d 644, 653 (Ind. 2005)).

194. *See id.* at 29 (adopting Restatement and holding that Wells Fargo was equitably subrogated to first-priority lien, regardless of actual or constructive knowledge of intervening liens).

195. 274 P.3d 1204 (Ariz. 2012) (en banc).

196. *See id.* at 1209 (adopting Restatement approach, and rejecting agreement requirement for equitable subrogation). The court held that equitable subrogation "does not turn on contractual principles, but instead on the concern to prevent unjust enrichment." *Id.* (granting subrogation regardless of express or implied agreement).

197. *See id.* at 1206 (describing Dean and Stacey Norcutt's home purchase).

198. *See id.* (holding that purchasers were equitably subrogated to mortgage lien's priority in amount paid to satisfy mortgage).

199. *See id.* at 1207 (noting that prior precedent stated "[a] mere volunteer, who has no rights to protect, may not claim the right of subrogation" (quoting Mosher v. Conway, 46 P.2d 110, 113 (Ariz. 1935)). For a discussion of Pennsylvania's approach, specifically the requirement that a party seeking equitable subrogation must not be a volunteer, see *supra* notes 169–79 and accompanying text.

200. *See id.* (finding that Restatement approach was "most consistent with the rationale for equitable subrogation").

201. *See id.* at 1208 (holding that Arizona case law was consistent with Restatement approach, which refuses to use term "volunteer" as talisman). Further, the court agreed with the Restatement insofar as "[T]he meaning of the term 'volun-

nally, the court concluded that the goal of equitable subrogation was preventing unjust enrichment and acknowledged that denying subrogation in this case would grant a windfall to the judgment lienholder.[202]

C. *Pennsylvania Must Change Its Approach to Equitable Subrogation*

The volunteer rule in Pennsylvania's current law is not only out-of-date, but it defeats the purpose of equitable subrogation.[203] Pennsylvania's approach prevents equitable subrogation in all third party refinancing circumstances.[204] The purpose of the doctrine is to prevent unjust enrichment, which Pennsylvania's current approach completely fails to do.[205] A liberal application of equitable subrogation is essential to prevent junior lienholders from gaining an undeserved windfall.[206] Furthermore, Pennsylvania causes buyers and lenders to suffer substantial losses by denying equitable subrogation in the refinancing context.[207] As the court found in *Prestance*, the purpose of equitable subrogation is to preserve the rightful lien position of lenders.[208] Accordingly, adopting the Restatement approach will encourage refinancing and allow homeowners to take full advantage of low interest rates.[209] Moreover, Penn-

teer' is highly variable and uncertain, and has engendered considerable confusion." *Id.* (alteration in original) (quoting RESTATEMENT (THIRD) PROP.: MORTGS. § 7.6 cmt. b (1997)).

202. *See id.* at 1209 ("Equitable subrogation, however, does not turn on contractual principles, but instead on the concern to prevent unjust enrichment."). The court noted that the Restatement "appropriately focuses" on circumstances surrounding subrogation. *See id.* at 1208 (looking at party's interest in property).

203. *See Subrogation*, *supra* note 44, at 684 (suggesting that volunteer requirement should be abandoned, and equitable subrogation doctrine expanded).

204. *See* Ominsky, *supra* note 26 ("A lender who extends a loan in order to pay off earlier loans is a 'volunteer' . . . because the lender was 'an entirely voluntary agent with no interest in the property . . . .'" (quoting 1313466 Ontario, Inc. v. Carr, 954 A.2d 1, 4 (Pa. Super. Ct. 2008))).

205. *See* RESTATEMENT (THIRD) PROP.: MORTGS. § 7.6 cmt. a (1997) ("Subrogation is an equitable remedy designed to avoid a person's receiving an unearned windfall at the expense of another.").

206. *See Bank of Am. v. Prestance Corp.*, 160 P.3d 17, 20 (Wash. 2007) (en banc) ("It rests upon the maxim that no one shall be enriched by another's loss, and may be invoked wherever justice and good conscience demand its application in opposition to the technical rules of law." (quoting Cox v. Wooten Bros. Farms, Inc., 610 S.W.2d 278, 280 (Ark. Ct. App. 1981))).

207. *See* Nelson & Whitman, *supra* note 16, at 363 (arguing that widespread adoption of Restatement approach is likely to lead to substantial savings for refinancing homeowners). Furthermore, the authors argue that the Restatement approach is the "fairest" because it rejects conferring a windfall to intervening lienholders. *See id.* at 327.

208. *See Prestance*, 160 P.3d at 28 (concluding that allowing subrogation provides incentive for lenders to advance loans to borrowers in order to avoid forfeiture). Moreover, the court found that the Restatement approach "affords enormous financial benefits for many homeowners." *Id.* (noting that potential savings amount to billions of dollars).

209. *See* Nelson & Whitman, *supra* note 16, at 327 ("[T]he Restatement approach is friendly to first mortgage refinancing, a process that clearly is beneficial

sylvania should relinquish the volunteer rule and base decisions on equity rather than actual or constructive notice.[210] By adopting the Restatement approach, Pennsylvania would protect the rights of lenders and preserve the proper role of equity in refinancing transactions.[211]

Furthermore, adoption of the Restatement would facilitate refinancing and help curb the threat of foreclosure.[212] The court in *Prestance* recognized that a liberal application of equitable subrogation encourages lenders to refinance loans and allows property owners to avoid forfeiture.[213] In addition, the Restatement approach affords tremendous financial benefits to homeowners by allowing seamless refinancing.[214] In the current state of the economy it is vital to encourage refinancing because it allows homeowners to maximize the value in their home.[215] Moreover, adopting the Restatement approach would limit the costs of title insurance for refinancing transactions, which would save borrowers over a billion dollars.[216] Equitable subrogation protects both lenders and borrowers,

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to homeowners."). The authors strongly urge the adoption of the Restatement approach to equitable subrogation, arguing that it should become the predominant approach. See *id.* at 327–28 (noting that Restatement approach has gained considerable ground).

210. *See* Sourcecorp, Inc. v. Norcutt, 274 P.3d 1204, 1208 (Ariz. 2012) (en banc) (finding that person who pays debt to protect person's interests is not volunteer). The court makes clear that the volunteer rule is "highly variable and uncertain, and has engendered considerable confusion." *Id.* (quoting RESTATEMENT (THIRD) OF PROP.: MORTGS. § 7.6 cmt. b (1997)).

211. *See* Nelson & Whitman, *supra* note 16, at 353 (noting that lenders and title insurers both support adoption of Restatement for equitable subrogation because it dramatically reduces financial risk associated with refinancing and lessens threat of intervening lienholder taking priority position). The authors ultimately conclude that the Restatement approach should be enacted by Congress in the form of legislation. *See id.* at 366.

212. *See Prestance*, 160 P.3d at 28 ("[B]y facilitating more refinancing, equitable subrogation helps stem the threat of foreclosure."). The court notes that other courts have liberally applied equitable subrogation in order to prevent forfeiture. *See id.*

213. *See id.* ("By allowing subrogation there is an incentive for one to advance sums to help a property owner avoid forfeiture." (quoting Klotz v. Klotz, 440 N.W.2d 406, 410 (Iowa Ct. App. 1989))).

214. *See* Nelson & Whitman, *supra* note 16, at 365–66 ("[T]itle insurance costs in residential mortgage refinancings represent billions of dollars annually—costs that are now borne overwhelmingly by homeowners."). The authors recognize that the potential savings from adopting the Restatement could approach billions of dollars. *See id.* at 366.

215. *See Mortgages and the Markets*, *supra* note 8 (recognizing that refinancing provides economic stimulus by lowering borrowers' mortgage payments and increasing their expendable income).

216. *See Prestance*, 160 P.3d at 28 ("Title insurance primarily ensures there are no intervening liens, and when a jurisdiction adopts the liberal view of equitable subrogation, the insurance premium is greatly reduced."). The court recognized that the savings from title insurance premiums would be passed to homeowners. *See id.* (citing Nelson & Whitman, *supra* note 16, at 365).

and Pennsylvania must adopt the Restatement approach in order to promote confidence in the struggling housing market.[217]

The court in *Carr* presents a compelling case-in-point of the need for Pennsylvania to adopt the Restatement approach, and also suggests a way forward.[218] The court noted that Carr would not be able to refinance his mortgage with an intervening loan on the property.[219] Furthermore, under Pennsylvania law, if Carr knew of the intervening lien, neither he nor the bank could take advantage of equitable subrogation.[220] As the court noted, Pennsylvania's application of equitable subrogation "may be ripe for legislative review."[221]

The dilemma that Carr faced was a frequent problem for homeowners during the mortgage crisis.[222] Therefore, if Pennsylvania wants to protect homeowners against foreclosure, it must promote refinancing.[223] The first step Pennsylvania must take is adopting the Restatement approach to equitable subrogation.[224] In doing so, Pennsylvania will allow borrowers and lenders to protect their individual interests and capitalize on improving conditions in the housing market.[225]

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217. *See* Nelson & Whitman, *supra* note 16, at 327 ("Restatement approach is friendly to first mortgage refinancing, a process that clearly is beneficial to homeowners.").

218. *See* 1313466 Ontario, Inc. v. Carr, 954 A.2d 1, 5 (Pa. Super. Ct. 2008) (explaining that Carr could not refinance his home if he was aware of intervening lien); *id.* at 6 (alluding to legislative adoption of Restatement approach).

219. *See id.* (noting that if bank was aware of intervening mortgage then it would not have extended loan to Carr to refinance his home).

220. *See id.* (noting that U.S. Bank would not have extended loan to Carr if it knew of the intervening lien). The court explains that under the Pennsylvania approach neither Carr nor U.S. Bank could take advantage of equitable subrogation, leaving Carr unable to refinance his home altogether. *See id.*

221. *Id.* at 6.

222. *See id.* at 5–6 ("This scenario may be a frequent dilemma for homeowners amidst the current mortgage crisis, where 1.3 million housing properties were subjected to foreclosure activity in 2007, and estimates predict that capital losses in housing may reach into the trillions of dollars in the coming years." (footnote omitted)). The court recognized the millions of homes foreclosed upon, and thus the importance of refinancing. *See id.* (suggesting legislative review for Pennsylvania's equitable subrogation approach).

223. *See* Stiglitz & Zandi, *supra* note 6 (explaining that with interest rates at record lows, mass mortgage refinancing would allow homeowners to drastically reduce their monthly payments and chance of default). The authors highlight the benefit homeowners receive from refinancing. *See id.* (noting that majority of Americans are great candidates).

224. *See* Nelson & Whitman, *supra* note 16, at 327–28 ("[A]s a normative matter, we strongly urge the adoption of the Restatement subrogation rule. It has already gained considerable ground, and we believe and hope it is well on its way to becoming the predominant rule."). The authors note that the widespread adoption of the Restatement approach would lead to substantial savings for refinancing homeowners. *See id.*

225. *See* Ensign, *supra* note 18 (encouraging homeowners to refinance and take advantage of historically low interest rates); *see also* Nelson & Whitman, *supra*

V. CONCLUSION

Without the opportunity to refinance her home, Jan and her children would have been forced out onto the street.[226] In order to reduce the chances of this occurring, Pennsylvania must adopt a more liberal approach to equitable subrogation.[227] Pennsylvania's current equitable subrogation law makes refinancing an extremely risky decision for lenders.[228] The goal of equitable subrogation is to prevent intervening lienholders from receiving an undeserved windfall, which the Pennsylvania approach does not do.[229] In order to allow borrowers to take full advantage of the benefits of refinancing, Pennsylvania must adopt the Restatement approach.[230] In doing so, Pennsylvania would follow a growing trend in the country and provide an outlet to those homeowners who want take advantage of low interest rates.[231] In a housing market that is still recovering from a crushing recession, it is imperative that Pennsylvania adopt an ap-

note 16, at 327 (concluding that Restatement approach for equitable subrogation is "fairest" and friendly to first mortgage refinancing).

226. *See Foreclosure Statistics*, *supra* note 13 (reporting spike in foreclosures during 2008, and describing problems homeowners face when dealing with foreclosure).

227. *See* RESTATEMENT (THIRD) PROP.: MORTGS. § 7.6 cmt. e (1997) ("The most common context for this sort of subrogation is the 'refinancing' of a mortgage loan."). The most frequent occurrence is when a payor is given a mortgage, but without subrogation, it would be subordinate to some intervening lien. *See id.* (describing significance of priority and explaining role equitable subrogation plays).

228. *See* Ominsky, *supra* note 26 ("[I]n Pennsylvania '[t]he payor must have acted on compulsion, and it is only in cases where the person paying the debt of another will be liable in the event of a default or is compelled to pay in order to protect his own interests, or by virtue of legal process, that equity substitutes him in the place of the creditor without any agreement . . . .'" (second alteration in original) (quoting 1313466 Ontario, Inc. v. Carr, 954 A.2d 1, 4 (Pa. Super. Ct. 2008))).

229. *See id.* § 7.6 cmt. a ("Subrogation is an equitable remedy designed to avoid a person's receiving an unearned windfall at the expense of another."); *see also* Murray, *Trend*, *supra* note 45, at 19 (explaining that doctrine of equitable subrogation "rests on the equitable maxim that no one shall be enriched by another's loss," and noting it "is designed to prevent an unjust forfeiture on one hand and a windfall amounting to unjust enrichment on the other").

230. *See* Nelson & Whitman, *supra* note 16, at 305 (finding that majority of refinancing expenses can be substantially reduced or eliminated by implementing Restatement). Further, the authors state that making subrogation available liberally can eliminate risk that intervening liens will take priority over refinancing mortgage. *See id.* at 305–06 (noting that adopting Restatement would greatly reduce need for title insurance when refinancing).

231. *See, e.g.*, Sourcecorp, Inc. v. Norcutt, 274 P.3d 1204, 1207 (Ariz. 2012) (en banc) (adopting Third Restatement approach to equitable subrogation because it is most consistent with rationale of doctrine); CitiMortgage, Inc. v. Mortg. Elec. Registration Sys., Inc., 813 N.W.2d 332, 334 (Mich. Ct. App. 2011) (finding that case law in Michigan was consistent with Restatement approach with regard to refinancing); Bank of Am., N.A. v. Prestance Corp., 160 P.3d 17, 29 (Wash. 2007) (en banc) (adopting Restatement approach in context of conventional refinancing and holding that equitable subrogation applied regardless of actual or constructive knowledge).

proach to equitable subrogation that facilitates refinancing.[232] By adopting the Restatement approach, Pennsylvania would provide freedom to homeowners, security to lenders, and economic development to all.[233]

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232. *See* RESTATEMENT (THIRD) OF PROP.: MORTGS. § 7.6 cmt. e (1997) ("Ordinarily lenders who provide refinancing desire and expect [primary lien position], even if they are aware of an intervening lien.").

233. For a critique of Pennsylvania's current approach, see *supra* notes 121–65 and accompanying text. For a discussion of the Restatement approach and why Pennsylvania should adopt it, see *supra* notes 166–225 and accompanying text. *See* Nelson & Whitman, *supra* note 16, at 363 (concluding that widespread adoption of Restatement approach to subrogation and refinancing transactions is proper normative matter and will lead to substantial savings for refinancing homeowners). Adopting the Restatement approach would eliminate the risk of losing mortgage priority for refinancing lenders. *See id.* at 365 (advocating for reform of law of mortgage refinancing and concluding that Restatement approach should be enacted through federal legislation).